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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1944.

No. 380

CANADIAN RIVER GAS COMPANY, a Corporation, PETITIONER,

v.

FEDERAL POWER COMMISSION, CITY AND COUNTY OF DENVER, COLORADO, PUBLIC SERVICE COMMISSION OF WYOMING, COLORADO-WYOMING GAS COMPANY, PUBLIC SERVICE COMPANY OF COLORADO, and COLORADO INTERSTATE GAS COMPANY, RESPONDENTS.

BRIEF OF PETITIONER.

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BRIEF OF PETITIONER.

OPINION BELOW.

The Opinion of the Circuit Court of Appeals, Tenth Circuit, is reported in 142 Fed. (2d) 943. (R., V. 8, 5066-5094.) The Opinion and Order of the Federal Power Commission is reported in 43 P.U.R. (N.S.) 205. (R., V. 1, 140-195.)

GROUNDS UPON WHICH JURISDICTION OF THIS COURT IS INVOKED.

The jurisdiction of this Court is invoked under Section 19(b) of the Natural Gas Act (52 Stat. 821; Title 15, USCA, Sec. 717r) and Section 240a of the Judicial Code, as amended by the Act of February 13, 1925 (Title 28, USCA, Section

347). The sections of the Natural Gas Act pertinent to this review are set forth in Appendix A hereto.

THE QUESTIONS PRESENTED.

The Court, by its Order of November 13, 1944, granted certiorari limited to Question No. 8 presented in the Petition for Certiorari filed herein by Canadian River Gas Company, and by its Order of January 2, 1945, enlarged the scope of review so as to include Questions 1, 2 and 3 stated in the Petition for Certiorari. The four questions now presented for the consideration of the Court in the numerical sequence set forth in the Petition for Certiorari are as follows:

Question 1.

"Whether the Circuit Court, after correctly holding that the Commission has no rate regulatory jurisdiction over Canadian's production and gathering properties, facilities and business, erroneously concluded and ruled that the Commission in this case did not exercise such prohibited jurisdiction."

Question 2.

"Whether, even assuming, *arguendo*, that the Commission has rate regulatory jurisdiction over Canadian's production and gathering properties, facilities and business, the Commission can, consistently with the Fifth Amendment to the Constitution of the United States, the requirements of the Act, and the decisions of this Court in the Natural Gas Pipeline, Hope and other cases, limit Canadian generally to a return only on the 'wildcat' or original cost of its gas leaseholds to predecessor companies prior to discovery and development over 20 years ago, to the exclusion of all evidence of value, market or otherwise, the result of this procedure being, among other things, the inclusion in the Commission's rate base of a substantial block of Canadian's most valuable leaseholds at zero valuation and a still larger block of valuable leaseholds at only 10¢ per acre valuation."

Question 3.

"Whether, even assuming, *arguendo,* that the Commission has rate regulatory jurisdiction over Canadian's production and gathering properties, facilities and business, and further assuming, *arguendo,* that it is proper in this case to include Canadian's leaseholds and wells in the rate base on the basis of original cost, the Commission can, consistently with the Fifth Amendment to the Constitution of the United States, the requirements of the Act, and the principles announced by this Court in the Natural Gas Pipeline, Hope and other cases, disallow and eliminate more than $3,000,000, plus interest during construction paid thereon, from the amount actually invested by Canadian in its original acquisition of production properties in about 1928 solely upon the ground that the sum so eliminated allegedly represented a profit between affiliated companies, and, therefore, formed no proper part of the cost of said properties, where the Record clearly demonstrates that the transaction resulting in the acquisition of said properties was not between affiliates and that the price paid therefor was not excessive."

Question 8.

"Whether the Commission can, consistently with the Fifth Amendment to the Constitution of the United States and the provisions of the Act, reduce the rates and charges of Canadian on that part of its natural gas sales to Colorado Interstate which is not sold by the latter for ultimate distribution to the public but is sold by it directly to its industrial customers; furthermore, independent of the above question, whether the Commission erred in making no separation or allocation as between Canadian's properties devoted to intrastate sales in Texas and its properties devoted to interstate sales, or as between the properties of Canadian and the properties of Colorado Interstate, and in using in lieu thereof a substitute method of allocation of cost of service which results in burdening non-regulable gas with costs actually chargeable against regulable gas, in violation of the Fifth Amendment to the Constitution of the United States and the Act."

ABBREVIATIONS USED.

For the sake of brevity the following abbreviations will be used herein:

"R.," for the printed Record filed herein, and "V" for the "Volume" of the Record, followed by the page number in the Record to which reference is made.

"Circuit Court" for "United States Circuit Court of Appeals for the Tenth Circuit."

"Commission" for "Federal Power Commission."

"Act" for "Natural Gas Act of 1938."

"Amarillo" for "Amarillo Oil Company."

"Canadian" for the petitioner, "Canadian River Gas Company."

"Colorado Interstate" for "Colorado Interstate Gas Company."

"Southwestern" for "Southwestern Development Company."

"Standard" for "Standard Oil Company (New Jersey)."

"Cities Service" for "Cities Service Company."

"Cost Contract" for the Agreement dated as of January 3, 1928, between Canadian and Colorado Interstate covering the purchase and sale of gas at cost under the terms of which petitioner has been ordered by the Commission to reduce its rates or charges in the amount of $551,000 annually.

"Natural Gas Pipeline case" for "*Federal Power Commission v. Natural Gas Pipeline Company*," 315 U. S. 575.

"Hope case" for "*Federal Power Commission v. Hope Natural Gas Company*," 320 U. S. 591.

STATEMENT OF THE CASE.

The Commission entered an order following a hearing, affirmed by the Circuit Court, reducing the purchase price for natural gas and compensation for the performance of other contract obligations, which Canadian is entitled to

receive, in the aggregate sum of $561,000 annually. Such total reduction is in the amount of $10,000 annually for natural gas sold by Canadian to Clayton Gas Company for resale in the Town of Clayton, New Mexico, and in the amount of $551,000 annually for the compensation (including the sale price of gas) which Canadian is entitled to receive under the Cost Contract between Canadian and Colorado Interstate. An investigation of the rates charged by Colorado Interstate for the sale of its gas was also had by the Commission, and the Canadian and Colorado Interstate cases were consolidated for the purpose of the hearing, and the Commission likewise entered its separate order requiring a reduction in the rates charged by Colorado Interstate. Limited review has been granted by this Court to Colorado Interstate in Case No. 379 to the action of the Circuit Court in affirming the Commission's rate reduction order as against Colorado Interstate.

As Canadian's case and Colorado Interstate's case were consolidated for the hearing before the Commission, a joint printed Record in their respective cases was filed in the Circuit Court and a joint printed Record has been filed here, although the two cases are entirely separate and independent cases.

The printed Record is approximately 5100 pages in length, but we shall do our best to summarize in as brief a space as possible the portions of this lengthy Record deemed pertinent to a consideration of the four questions presented herein.

While almost all of the record facts hereinafter set forth or summarized are pertinent to all four questions presented, some have particular pertinency to specific points. For the convenience of the Court, therefore, we shall first submit a brief statement of general historical facts pertinent to all questions presented, and then summarize under separate headings additional facts which are particularly pertinent to the separate questions indicated, with the understanding that such facts may likewise be pertinent to one or more of the other questions.

The Petitioner.

As stated by the Commission in its Opinion (R., V. 1, 143), Canadian is engaged in several different and distinct business operations or functions; viz., (a) production; (b) gathering; (c) transportation, and (d) sales of natural gas. Its producing and gathering operations are conducted wholly within the Texas Panhandle Field in the State of Texas. It owns and operates in that field approximately 300,000 acres of natural gas leaseholds, and, as of December 31, 1939, was operating 94 gas wells thereon, and its gathering system consisted of approximately 144 miles of various sizes of pipe. Canadian produces from its own properties *all* gas which it sells.

Canadian owns and operates one transmission line commencing at Bivins Station, being one terminus of its gathering system in the Texas Panhandle Field, Texas, and ending at a point near the Town of Clayton, New Mexico. It leases other transmission facilities commencing at another terminus of its gathering system in the Texas Panhandle Field known as Fritch Station and ending at a point near Gray, Oklahoma.

Canadian sells substantial quantities of gas *at the well head* in the Texas Panhandle Field to Amarillo Oil Company for the City of Amarillo and the Town of Channing, Texas, and along its transmission line for the Dalhart, Hartley and Texline, Texas, markets, all of which are purchased and consumed wholly within the State of Texas. It transports gas through its transmission line to a point near Clayton, New Mexico, which is about 85 miles from the field. Some of the gas so transported by Canadian is there sold and delivered to the Clayton Gas Company for distribution in the Town of Clayton, New Mexico. The greater portion of the gas so transported by Canadian is there sold and delivered to Colorado Interstate, and then transported, sold and delivered by Colorado Interstate through its own transmission facilities which start at Clayton Junction, New Mexico, and continue northward about 300 miles to the Denver, Colorado, city limits. Part of the gas so purchased and transported by Colorado Interstate is sold by it for resale for ultimate public consumption, and

part is sold by it directly to its own industrial consumers. Canadian also sells a quantity of gas to Colorado Interstate for resale to Natural Gas Pipeline Company of America, which is delivered through the leased facilities mentioned above to Colorado Interstate at Gray Junction, Oklahoma (R., V. 2, 708).

The gas sold by Canadian to Colorado Interstate at Clayton Junction, New Mexico, is sold and delivered pursuant to a contract between Canadian and Colorado Interstate, dated as of January 3, 1928, (Ex. 16, R., V. 2, 711-780), known as the "Cost Contract" under which Canadian is required to perform numerous obligations, such as maintaining and renewing its gas leasehold interests, drilling wells, constructing and maintaining necessary pipe line and other facilities in order to supply Colorado Interstate's markets and to produce, gather, transport and sell its gas to Colorado Interstate at Canadian's cost for a fixed period of 20 years and so long thereafter as Colorado Interstate elects to buy. It is the over-all compensation which Canadian is entitled to receive under this Cost Contract which the Commission's rate reduction order requires to be reduced to the extent of $551,000 annually.

The location of Canadian's production and gathering properties in the Texas Panhandle Field, Texas, its transmission system, and the connecting transmission system of Colorado Interstate and other related matters are shown on a Flow Map, Commission's Exhibit 138, reproduced copy of which is attached hereto as Appendix B. (R., V. 2, 1079.)

General History of Canadian's Gas Leasehold Properties.

Over 27 years ago (1917), a few ranchers and small businessmen residing in and about Amarillo, Texas, incorporated and organized a small corporation called "Amarillo Oil Company," for the purpose of drilling a "wildcat" well for oil in what has now become the great Texas Panhandle Field in the State of Texas. (R., V. 5, 2837, 3040.) At that time there had been no discovery of oil or gas within 200 miles of the proposed well location. (R., V. 7, 3673.) Consequently, the cost to Amarillo of assembling the block of leases to be tested was purely nominal, except for drilling obligations.

After many unfortunate experiences, financial and otherwise, the "wildcat" test well was finally completed in the fall of 1918 as a gas well—the first commercial producer of either oil or gas in the Texas Panhandle Field. From that successful "wildcat" beginning, the field has been subsequently developed by the drilling of successive test wells until it now contains 1,500,000 proven acres on which there are located approximately 1,650 wells producing gas only, and approximately 4,200 wells producing both oil and gas. (R., V. 1, 409.) Canadian's acreage produces no oil.

In 1924 Southwestern became the owner of all the capital stock of Amarillo. In the meantime, Amarillo had acquired additional blocks of leaseholds in the field, and its total holdings were then approximately 300,000 acres. Substantially all of such leaseholds were likewise granted for oil exploration at a time when the acreage embraced therein was classified as "unproven" and valued accordingly. Additional test wells were drilled on this acreage, most of which proved to be substantial gas producers, although some resulted in dry holes.

Amarillo Oil Company had no market at that time for its gas production, except for relatively small sales *at the well head* for the City of Amarillo, Texas, and vicinity, and one industrial sale at a plant near Amarillo. It had one well with a capacity substantially in excess of the quantity required to supply its entire available market. (R., V. 1, 459.)

Added to the lack of adequate markets, the gas properties and investments of Amarillo were threatened at that time with still another menace. Tremendous volumes of gas in the field were being blown and wasted in the air, to the extent that it became a national scandal. (R., V. 7, 3673-3675.) Enormous quantities of gas were being consumed by carbon black plants and natural gasoline plants. The seriousness of the situation was ultimately recognized by the Texas Legislature, which enacted new legislation to control the wastage of gas, as well as its use for carbon black purposes. (R., V. 7, 3675-3676.)[1]

It became obvious that the Company could not realize upon

[1]Thompson v. Consolidated Gas Utilities Corp., 300 U. S. 55.

its extensive gas properties unless new markets of a substantial character were developed promptly. There were then no long-distance pipe lines connected to the field. Pipe line markets in the immediate vicinity of the field were either occupied or too small to be attractive, and it seemed advisable to look for markets at greater distances. (R., V. 1, 402.)

Origin of Denver Project.

The transportation of gas by pipe line over long distances was in its infancy. Neither Southwestern nor any of its affiliated companies had had any previous experience in transporting gas over long distances; moreover, Southwestern and its subsidiaries lacked the necessary capital with which to construct such a pipe line. (R., V. 1, 402, 403.) The City of Denver, located a distance of approximately 350 miles from the Texas Panhandle Field, and intervening territory, seemed to be the closest available market for natural gas in substantial quantities. (R., V. 1, 402.) In 1926 Southwestern approached Standard Oil Company (New Jersey) regarding the construction of a pipe line project to Denver and intervening territory, because the latter had had a long and successful experience in operating natural gas projects in other areas, and was fully able to finance such a project. (R., V. 1, 403.) Standard investigated the feasibility of the project with favorable results. Cities Service Company was then brought into the negotiations because its subsidiary, Public Service Company of Colorado, held a manufactured gas franchise in Denver; and another subsidiary company held a similar gas franchise in Pueblo, Colorado. (R., V. 1, 403.)

The three parties, to wit: Standard, which was experienced in operating long-distance pipe lines and had the ability to finance the same; Cities Service, which controlled important market outlets in Colorado through its subsidiaries; and Southwestern, which controlled substantial gas reserves in the Texas Panhandle Field through its subsidiary, Amarillo, began negotiations which continued for almost a year and finally culminated in an agreement between the parties on April 5, 1927, for the construction of a pipe line to Denver and intervening points and the acquisition

of gas leaseholds and wells owned by Amarillo for the project. (R., V. 1, 403-411.)

Neither Standard nor Cities Service had any interest whatsoever in either Amarillo or Southwestern on that date (April 5, 1927), prior thereto, or subsequent thereto. There was no corporate affiliation between any of the three participating companies which executed the contract of April 5, 1927. (R., V. 1, 460, 613-622.) *As stated above, the contract was entered into only after long and continued arm's-length negotiations between the parties:* (R., V. 1, 493-495; 518-526.)

The Denver Project agreement of April 5, 1927, between Standard, Cities Service and Southwestern (Ex. 1; R., V. 1, 381-400), known as the "Memorandum of Stipulations," sets out in considerable detail the terms and conditions under which the parties agreed to develop and participate in the project, but it is important here to point out briefly two of the principal obligations assumed thereunder by Southwestern.

Under this three-party agreement Southwestern obligated itself (1) to organize and incorporate a company (now Canadian), *separate and apart from its other companies and projects*, to which it would cause Amarillo to convey, free of all debts, liens and encumbrances, all of Amarillo's gas leaseholds, rights and wells in the Texas Panhandle Field at an agreed price of $5,000,000; and (2) to cause the company (Canadian) receiving such gas leaseholds, rights and wells to enter into a long-term contract to dedicate its gas reserves to the project and to sell gas to the principal project company (now Colorado Interstate) on a cost basis in consideration of the issuance by Colorado Interstate to Southwestern, as the nominee of Canadian, of 42½% of its authorized common stock with no par value and $1,000,000 par value of its authorized 6% preferred stock. (R., V. 1, 381-400.)

Canadian's Purchase of Gas Leaseholds, Rights and Wells for $5,000,000.

The purchase price of $5,000,000, as negotiated and agreed to by Standard, Cities Service and Southwestern, for the gas

leaseholds, rights and wells of Amarillo, which was to form the foundation for the project, was advanced and paid to Amarillo by Standard in two equal payments made in December, 1927, and January, 1928, which was prior to the incorporation of Canadian (R., V. 5, 2936). Pursuant to its obligation under the original three-party project agreement, Southwestern organized Canadian in February, 1928, *separate and apart from its other companies and projects,* and subsequently caused Amarillo to formally transfer and convey its gas leaseholds, rights and wells to Canadian. There were no negotiations whatsoever between Canadian and Amarillo (R., V. 1, 455-456).

To finance the several obligations imposed upon Canadian under the three-party agreement of April 5, 1927, i. e., to acquire gas-producing properties, to drill wells, to construct gathering facilities and transmission facilities, and to pay the agreed purchase price of $5,000,000 for the gas leaseholds, rights and wells of Amarillo, Canadian issued and sold to Colorado Interstate $11,000,000 principal amount of its 6% First Mortgage Bonds maturing in annual installments of approximately $600,000 through 1947. Out of the proceeds derived from the sale of its bonds to Colorado Interstate, Canadian repaid the $5,000,000 advance made by Standard to finance Canadian's purchase of gas leaseholds, rights and wells from Amarillo (R., V. 1, 406, 462; R., V. 2, 656-685).

Canadian's Cost Contract With Colorado Interstate.

Acting again in pursuance of the obligations imposed upon it under the terms of the three-party project agreement of April 5, 1927, Canadian, for the consideration hereinabove described, entered into a contract with Colorado Interstate as of January 3, 1928, to furnish Colorado Interstate with its natural gas requirements at cost over a period of years (Ex. 16; R., V. 2, 714-780).

This particular contract is unusual and unique in many respects. It is not the ordinary contract for the current purchase and sale of natural gas as a commodity, and it is not the ordinary contract that courts or regulatory bodies are called upon to consider when confronted with a challenge

to the right of abrogation. Briefly, the Cost Contract, and Canadian's related Trust Indenture (R., V. 2, 656-685) securing its bonds held by Colorado Interstate, require Canadian:

(a) to maintain and renew all its gas leasehold interests, to drill necessary wells, and to construct and maintain necessary pipe line and other facilities in order to supply Colorado Interstate's market at all times with its gas requirements;

(b) to produce, gather, transport and *sell* its gas to Colorado Interstate *at absolute cost* for a fixed period of 20 years, and so long thereafter as Colorado Interstate elects to buy;

(c) to dedicate its gas reserves and facilities to the service of Colorado Interstate's market, with no right to sell or otherwise dispose of its gas or gas properties to others for carbon black, industrial or any other purpose without the consent of Colorado Interstate (except for outstanding commitments to sell gas to Amarillo Oil Company to supply the Amarillo market)[2]; and

(d) to credit Colorado Interstate's cost of gas with any and all revenue, income or profits which it may receive from *any* source, and to continue to operate strictly as a non-profit company for the full term of the Cost Contract.

The cost of gas delivered by Canadian to Colorado Interstate under the Cost Contract is computed by deducting all outside revenues[3] received by Canadian (including sales of gas to others) from the aggregate cost of producing and delivering all gas sold to all purchasers. Such cost includes interest on and amortization of Canadian's funded and other

[2]Canadian has two outstanding contract obligations to sell gas *at cost* i.e.: (1) to supply all markets of Colorado Interstate, as above described and (2) to supply the Amarillo market of Amarillo Oil Company, which commitment was in existence long prior to the organization of Canadian and has certain preferential rights over all other markets of Canadian. (R., V. 1, 402; V, 2, 714, 715, 748)

[3]For example, in 1929 Canadian received in excess of $500,000 from the United States Government in final payment of the purchase price for certain helium-bearing leaseholds and wells of Canadian. Since the sum so paid represented revenues received by Canadian, it was likewise credited as a deduction against Colorado Interstate's current cost of gas under the Cost Contract. (R., V. 5, 2723; R., V. 1, 381-401)

indebtedness, but does not include depreciation and depletion, or retirements.

Thus, it will be seen that for the services to be rendered to it by Canadian under the Cost Contract, Colorado Interstate agreed to underwrite and guarantee Canadian's net cost of operations after crediting profits or income from all other sources, but no more. Moreover, Colorado Interstate was granted direct and complete control over Canadian's costs which it is obligated to reimburse. Obviously, Canadian has not paid, and cannot pay so long as the Cost Contract is in effect, any dividends, earnings or profits in any manner to the owners and holders of its capital stock. This Contract, as above indicated, covers not only Canadian's transmission system, but also its production and gathering properties, facilities and business. Under the Cost Contract Canadian's receipts in any given year can never exceed its actual costs.

Canadian's Trust Indenture provides that in case of default thereunder, in addition to the usual remedies of foreclosure, etc., the Trustee may forthwith take possession of, operate, manage and control the trust estate and, at its discretion, may sell the trust estate to the highest and best bidder "who will assume and perform the obligations of the company" under its Cost Contract with Colorado Interstate. The trust estate *must* be sold in one parcel and as an entity, and the purchaser or purchasers at any sale *must* be required to assume the performance of Canadian's obligations under its Cost Contract with Colorado Interstate.

The Commission's Findings and Order and the Circuit Court's Affirmance Thereof.

The Commission's "Order Reducing Rates," its Opinion supporting such order, and the Opinion of the Circuit Court affirming such order, raise several important questions which form the basis of the petition in this case. Canadian contends that on a rate regulatory theory or any other theory the Commission in its various findings and ultimately in its rate reduction order, committed numerous errors of law, constituting violations of the Act itself and which necessarily deprive Canadian of its property without due process

in violation of the Fifth Amendment, and that viewed as a whole, the rate reduction order cannot be sustained under the "end result" or "rate impact" principles announced by this Court in the Natural Gas Pipeline and Hope cases. In so far as deemed pertinent at this time, the following additional statements are submitted with respect to the questions involved:

1. *Jurisdiction Over Production and Gathering (Question 1).*

In its Opinion (R., V. 1, 147), the Commission has sought to justify its exercise of rate regulatory jurisdiction over Canadian's producing and gathering properties by stating that "Canadian's production and gathering operations are an integral part of its total operations, including transportation in interstate commerce and the sale of natural gas for resale in interstate commerce" and that "Canadian's operations are an integral part of Colorado's operations and the two comprise a single operating system."

In their Answer Brief (pp. 19-25) before the Circuit Court, counsel for the Commission were even more positive and expansive with respect to the alleged rate regulatory powers of the Commission over Canadian's producing and gathering properties and operations. After stating that Canadian's claims of the lack of such jurisdiction were without merit even though "the determination of the rates, through rate base, etc., touches incidentally on production and gathering", because "such a construction would frustrate and nullify the very purpose of Congress", they conclude that "the Commission has jurisdiction of production and gathering so far as production and gathering is in aid of sales of natural gas in interstate commerce for resale subject to the rate jurisdiction of the Commission".

During the course of the hearing, the Commission overruled Canadian's objections to the introduction of *rate regulatory* evidence relating to production and gathering, notwithstanding that Section 1 (a) of the Act declares only that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public in-

terest and that the regulation of such business is necessary in the public interest, and notwithstanding that Section 1 (b) of the Act delegates only to the Commission rate regulatory jurisdiction over the interstate transportation and sale of natural gas for resale for ultimate public consumption and expressly provides that the Act "shall not apply * * * to the production or gathering of natural gas" (R., V. 5, 2639, 2640).

The Circuit Court did not agree with the Commission's contentions in this respect. It ruled as a matter of law that the Commission does not have rate regulatory jurisdiction over production and gathering, but then further ruled and held that what the Commission did in this case does not constitute the exercise of rate regulatory jurisdiction over production and gathering (R., V. 8, 5073-5075). There has been no appeal by the Respondents from such rulings or any part thereof. Thus, there is presented here for consideration the specific question as to whether the Commission has, in this case, as a matter of fact or in legal effect, exercised rate regulatory jurisdiction over Canadian's producing and gathering properties and operations, which is expressly prohibited by the Act.

In support of its contention that the Commission, with the Circuit Court's affirmance, has in fact and legal effect exercised prohibited rate regulatory jurisdiction over Canadian's producing and gathering properties and operations, Canadian maintains that the Commission has treated every element of Canadian's production and gathering properties, facilities and business in precisely the same manner as its interstate transmission properties, facilities and business and has subjected every element of Canadian's production and gathering facilities to the same rate regulatory measures and procedures as Canadian's Interstate transmission properties, facilities and business for the purpose of arriving at its ultimate conclusions with respect to rates and charges, and that if the Act had expressly delegated full and complete rate regulatory jurisdiction over Canadian's production and gathering properties, facilities and business, the Commission could have done no more than it has done in this case.

In this connection, the following facts from the Record are now summarized:

(a) The Record contains uncontradicted evidence as to the fair market value of Canadian's gas as a commodity at the wellhead in the field and at the end of Canadian's gathering system, which is the beginning point of interstate transportation (R., V. 6, 3256, 3280; Exhibit 168, Sheets Nos. 113, 114 and 127; R., V. 6, 3281). This evidence consisted of the testimony of Canadian's witnesses, R. A. Ford and R. J. Wallace, corroborated by the testimony of Commission witness, Lester B. McKinstry. It was not contradicted and established a 4¢ per Mcf commodity market value for Canadian's gas at the wellhead in the field (16.4# pressure base) and at least a 7¢ per Mcf commodity market value for the gas at Bivins Station, Texas, which is one terminus of the gathering system and the beginning of the interstate transportation. Canadian contends that this commodity value of Canadian's gas should be used as the Commission's jurisdictional starting point, but the Commission in its Opinion completely ignored such commodity value (R., V. 1, 140-195).

(b) In assuming and exercising full rate regulatory jurisdiction over Canadian's production and gathering properties and operations, the Commission included in its rate base for Canadian not only Canadian's interstate transmission properties, but also its production and gathering properties (R., V. 1, 144-195; V. 5, 2717-2721). Approximately two-thirds of Canadian's total rate base as found by the Commission in the amount of $9,375,000 (R., V. 1, 187) represents production and gathering properties of Canadian (R., V. 5, 2717-2721). The Commission expressly found (R., V. 1, 187) that it is such a rate base, including production and gathering properties, upon which Canadian is entitled to earn a fair rate of return as fixed by the Commission.

(c) In its rate base for production and gathering properties, the Commission determined and included an allowance for working capital which it deemed sufficient to enable Canadian to carry on its production and gathering operations and, likewise, the Commission has purported to determine in its rate base for production and gathering properties

what additional wells should be drilled and what additional gathering facilities should be installed in the future (R., V. 5, 2530-2556).

(d) After finding Canadian's total rate base to be $9,375,000 (R., V. 1, 187), of which approximately two-thirds represents production and gathering properties (R., V. 5, 2717-2721) (even on the Commission's basis of determining a rate base), the Commission then found that Canadian was entitled to a return of 6½% per annum upon its total rate base (R., V. 1, 187), more than two-thirds of which, as above stated, is attributable to the hazardous business of discovering, exploring, developing and operating natural gas production properties.

(e) The Commission has determined and made an allowance for Canadian's total annual operating expenses (including depreciation and depletion), the greater portion of which represents the cost of producing and gathering natural gas (R., V. 1, 171; V. 4, 2341-2345).

(f) After determining the total annual income of Canadian from all sources, the greater portion of which represents the cost of producing and gathering natural gas under its Cost Contract with Colorado Interstate, the Commission has deducted its determined annual operating expenses (mostly production and gathering) from such total income, and then, after making a return allowance of 6½% upon its determined rate base (mostly production and gathering), it has found an alleged excess income being received by Canadian, which forms the basis for its rate reduction order (R., V. 1, 187).

(g) As appears from the Commission's Opinion (R., V. 1, 173-176), the Commission, following its application of its cost allocation formula, hereinafter under Question 8 more fully detailed, has found that Canadian has an excess revenue over costs in the total amount of $615,000. This finding is based upon its conclusions from the Record as above outlined and as above shown includes its various and sundry determinations with respect to all of Canadian's business and properties, including production and gathering, intrastate sales in Texas and interstate direct gas sales, as well as interstate resale gas sales. Through the application of such

allocation formula hereinafter detailed, the Commission's rate reduction order requires Canadian to reduce the compensation which it is entitled to receive from Colorado Interstate by the sum of $551,000 annually (R., V. 1, 176, 187, 188).

(h) As hereinbefore explained, Canadian sells gas to Colorado Interstate under a Cost Contract (R., V. 2, 711-780). The Commission has designated this contract as "FPC Rate Schedule No. 1." Under this Cost Contract, Canadian is obligated to perform various obligations and services, in addition to selling and delivering gas to Colorado Interstate as a commodity, some of which are clearly beyond the jurisdiction of the Commission, namely, to acquire, maintain and develop a substantial block of gas leaseholds, to drill and operate wells, to construct and operate gathering facilities, to pay off Canadain's funded debt in fixed amounts at fixed times, to sell gas to others only as permitted by Colorado Interstate, and finally to receive from Colorado Interstate as compensation for the rendering of all of these services (and including the purchase price of the gas actually purchased) only Canadian's actual net cost[4] incurred in connection therewith. Since Canadian sells its gas to Colorado Interstate at its actual net cost[4], Canadian's annual revenue must always be in exact balance with its annual expenses, and it can never make a profit. The Commission's rate reduction order, following the application of its cost allocation formula, abrogates the compensation provision of this Cost Contract by reducing the cost reimbursement Canadian is entitled to receive thereunder by $551,000 annually which means $551,000 below Canadian's actual expense. The Commission's order, however, does not purport to relieve Canadian from the obligation to perform all obligations and render all the services required of it under the Cost Contract, all of which means that Canadian will have an expense of $551,000 annually more than it will be entitled to receive under the Commission's rate reduction order. This is done notwithstanding the fact that the Cost Contract, in addition to covering the sale of resale gas subject to the Commission's jurisdiction, also covers direct sale gas not subject to its

[4]The cost paid by Colorado Interstate is Canadian's total cost less all revenues received by Canadian from all other sources.

jurisdiction and gas sold intrastate in the State of Texas over which the Commission has no jurisdiction, and likewise covers production and gathering operations and expenses over which the Commission has no jurisdiction.

2. *Valuation of Canadian's Leasehold Properties (Question 2)*

It is further Canadian's contention that, even assuming, *arguendo*, that the Commission does have rate regulatory jurisdiction over its production and gathering properties, facilities and business, it is entirely improper to include Canadian's leaseholds in a rate regulatory rate base on the Commission's original cost or prudent investment theory, ignoring all evidence of value which appears from the uncontradicted evidence in the case, and that original cost or prudent investment is entirely inappropriate for determining the basis of inclusion of gas leaseholds in a rate base, and the use of such an exclusive test or basis cannot result in just and reasonable rates either to Canadian or the public and must necessarily deprive Canadian of its property without due process in violation of the Fifth Amendment.

In considering Canadian's gas leasehold properties for rate base purposes, the Commission has limited its consideration to the original cost of acquisition, commencing with the leases upon which the first discovery well of Amarillo Oil Company was drilled in 1918. This practice of the Commission purports to limit Canadian generally to a return of 6½% per annum on only the "wildcat" value of its leaseholds while in the hands of predecessor companies, to the exclusion of all discovery, market or other values, notwithstanding the fact that prior to the acquisition by Canadian none of such gas leaseholds had produced gas for interstate transportation, and none of such gas leaseholds had been devoted to a public use (R., V. 1, 459; V. 5, 2861-2927-2929). Canadian contends (even assuming rate regulatory jurisdiction) that original cost is not the proper basis for the inclusion of gas-producing leaseholds in a rate base, and that the Commission has erred in blindly following its original cost and prudent investment theories with respect to Canadian's

gas leaseholds and in wholly disregarding uncontroverted evidence of value.

An analysis of the testimony of Commission witnesses, which the Commission adopted substantially (Ex. 146, Sheets 62-64; R., V. 5, 2717, 2721), shows that the Commission used the sum of $1,604,020.61 as the starting point for its findings as to original cost of or investment in Canadian's leaseholds as of December 31, 1939. Then, as appears from Paragraph 8 of the Commission's formal findings (R., V. 1, 186), a deduction of $653,681 was made for depletion. This means that Canadian's bare leaseholds have been included in the Commission's original cost rate base at a value of something less than $1,000,000.

In adopting this valuation for rate base purposes, the Commission has wholly ignored substantial and uncontradicted evidence that "the present market value of Canadian's leaseholds" (excluding wells) is the sum of $15,646,787.64. This evidence is the testimony of Canadian's witness Wallace (Ex. 181; R., V. 6, 3181-3254). This Exhibit 181 was introduced through Canadian's witness R. J. Wallace, supported by lengthy and detailed testimony. His knowledge of the subject and qualifications are unchallenged. The Exhibit covers in detail each particular lease of Canadian, data concerning the wells drilled thereon, the initial open flow and rock pressure, present open flow and rock pressure, the production to date, etc., and the present market value aggregating over $15,000,000 for Canadian's leaseholds themselves, exclusive of oil rights, and without giving any consideration to sales contracts, or producing wells, or equipment, and as if the wells were not connected to pipe lines. In other words, Wallace's valuation is for the bare gas leaseholds themselves.

The Commission has found that Canadian's recoverable gas reserves are 2,800,000,000 Mcf (R., V. 1, 159). Reducing these figures so found by the Commission to its *value of the gas in place*, it appears that the Commission, in effect, has found the present value of the gas in place to be only 34/1000ths of one cent per Mcf. On a comparative basis, and using Wallace's $15,646,787.64 valuation, as applied to the Commission's finding of 2,800,000,000 Mcf recoverable re-

serve, the value of the gas in place is approximately ½¢ per Mcf.

The original "wildcat" cost to Canadian's predecessors in interest of five important leaseholds, containing approximately 47,000 acres, allowed by the Commission is $4,244.24, which is less than 10¢ per acre (R., V. 5, 3051). Three of these leases are included *at zero valuation.* The present fair value of these same five leaseholds (exclusive of wells), as testified to by Wallace with supporting evidence as to such value, was $3,345,923 (R., V. 6, 3235, 3237, 3238, 3242, 3243). A similar situation exists in respect to the Commission's valuation of the remainder of Canadian's leaseholds (R., V. 5, 3051).

The Commission has wholly ignored all evidence of the market value of gas at the wellhead in the Texas Panhandle Field as a measure of the value of said leaseholds. Canadian's General Superintendent Ford testified that the market value of gas at the wellhead in the Texas Panhandle Field is not less than 4¢ per Mcf on a 16.4-pound pressure base, or not less than 3.6¢ per Mcf on a 14.65-pound pressure base (R., V. 6, 3255-3281). This testimony was corroborated by Wallace, and by Commission's Exhibit 168, Sheets 13 and 127 (R., V. 6, 3281).

In arriving at its rate base for Canadian, the Commission used its original cost or prudent investment theory not only for Canadian's interstate transportation properties, but also for its production and gathering properties, and completely ignored the fact that the latter properties are used for wellhead and intrastate sales in Texas and for direct interstate sales, over which the Commission has no jurisdiction. Moreover, as will hereinafter be more fully detailed, the Commission, in arriving at its original cost of prudent investment rate base actually deducted over $3,000,000 from Canadian's actual original cost of leaseholds and wells.

3. *Canadian's Actual Cost of Leasehold Properties (Question 3).*

Much of the evidence relating to the acquisition and actual cost of Canadian's leasehold properties is summarized at

pages 7-11, supra. In order to avoid repetition, reference is here made thereto.

The Commission did not question the fact that Canadian had actually invested in its gas properties the sum of $14,648,821 in cash as of December 31, 1939. It deducted from such actual cash investment for its rate base purposes, however, the sum of $3,370,817 on the ground that it represented "affiliated company profits," and in addition thereto the sum of approximately $245,000 representing interest during construction on such alleged profits (R., V. 1, 149-151). Virtually the full amount of such deduction arises out of the transaction heretofore related, in which Canadian acquired from Amarillo Oil Company all of the latter's gas leaseholds, rights and wells for the sum of $5,000,00 for the purpose of inaugurating the Denver Project in 1928.

In making this deduction from Canadian's actual investment in gas leaseholds, the Commission, for rate base purposes, relegated Canadian to the bare provable costs of such leaseholds incurred by Amarillo and its predecessors in title, which was the cost of such leaseholds prior to the time that any wells had been drilled thereon and prior to the time that it was definitely known whether any gas would ever be produced therefrom. At the time that many of said leaseholds were acquired the nearest oil and gas production was 200 miles distant. The Commission gave no consideration whatsoever to the fact that such leaseholds when acquired were unproven and had little or no value and that, therefore, only a nominal sum was paid for the same and it wholly ignored the fact that said leaseholds possessed great value after the discovery of gas thereon and that such discovery and the increase in value necessarily preceded any use of the same for any character of public service. The Commission further ignored the fact that said leaseholds were acquired by Canadian approximately 10 years after the original discovery of gas under such leaseholds and at a time when such leaseholds had a value far in excess of the original acquistion cost in their then "wildcat" and undeveloped state. The Commission also ignored the fact that the purchase of said leaseholds by Canadian resulted from an arm's length transaction as heretofore explained, and that there

was not even an intimation in the Record that Canadian paid an excessive or imprudent price for such leaseholds. The actions and theories of the Commission in this case, if carried to a logical conclusion, would deny the prospector, or "wildcat" oil and gas operator, all the fruits of his discovery, and would necessarily limit him to the actual outlay of cash, *without profit*, in an extremely hazardous and speculative enterprise.

As of August 1, 1924, Amarillo owned approximately 46,803 acres of developed leaseholds in which it had a total provable cost for the leaseholds as such, exclusive of the wells that had been drilled thereon, of approximately $4,244, or less than 10c per acre (R., V. 5, 3038, 3051, 3040). As of that date it acquired 244,114 acres of leaseholds from Mountain States Gas Company, upon which wells had been drilled or were then drilling, and from that date to May 1, 1927, it acquired 3,998 acres from various other persons (R., V. 5, 3051). It also acquired 30,235 acres from Mountain States which were classed as unoperated leaseholds, being leaseholds upon which no wells had then been drilled (R., V. 5, 3063).

The leaseholds acquired from Mountain States Gas Company were paid for by Amarillo through the issuance of its common stock. Such leaseholds had been acquired by Mountain States in an undeveloped "wildcat" state. No gas had been sold from said leaseholds prior to that date. The total cost to Mountain States and its predecessors in title for the acreage acquired by Amarillo in exchange for its capital stock was $273,095.88 for the 244,114 acres of operated gas leaseholds, which included, however, approximately $76,318, being the drilling cost of two wells (R., V. 5, 3041, 3042). When this latter sum is eliminated, the original acquisition cost of said Mountain States leaseholds approximated $200,000, or less than $1.00 per acre. In fact, on this basis, the largest leasehold involved, being the Bivins A 30, comprising 200,000 acres, had a provable cost to Mountain States of only $105,000 for the leasehold as such. This provable cost of approximately 50c per acre was the entire amount included in the rate base by the Commission for this very valuable leasehold, exclusive of development costs.

The leaseholds above referred to that were included in the rate base for only a very nominal sum, and on the basis of their original "wildcat" provable costs, plus a very small amount of additional acreage, had an actual value of approximately $15,646,787.64 for the leaseholds as such, exclusive of all well costs, according to the uncontradicted testimony of Wallace (R., V. 6, 3181-3254). Excluding the additional acreage, such leaseholds had a minimum value of approximately $15,000,000 and were included in the rate base at a figure but little, if any, in excess of $300,000.

It is frankly admitted by the Commission and Commission witnesses that Canadian actually paid Amarillo $5,000,000 in cash for the latter's gas leaseholds, rights and wells. (R., V. 1, 150). The Commission, however, ignored the entire transaction and found, for Canadian's rate base purposes, that Amarillo, commencing at a date prior to the drilling of its "wildcat" discovery well in 1918, had invested in the properties sold only the sum of $1,879,504, and that this sum should be further reduced by $128,534 by reason of an alleged profit of another predecessor company in a sale of property by it to Amarillo (R., V. 1, 150), all of which resulted in a so-called original cost to Amarillo of approximately $1,750,600, or $3,250,000 less than the sum actually paid by Canadian in cash for such properties. Most of such provable costs, however, resulted from the drilling of gas wells and other costs incidental to the development of such leases. The provable cost of leases as such was very nominal as hereinabove pointed out.

In arriving at such provable costs, the Commission ignored, among other things, the following:

1. A sum in excess of $50,000 expended in drilling a dry hole which was one of the early exploratory wells (R., V. 5, 287[illegible]; V. 6, 3111, 3112). This well was as much a part of the development cost as the producing wells, but its cost was eliminated apparently because no one should be so foolish or imprudent as to drill non-producing wells.

2. $35,000 for interest on idle investment prior to October, 1920, when the first small volume of gas was sold (R., V. 6, 3110-3111).

3. General overhead and administrative costs estimated at $68,000 (R., V. 6, 3108-3110).

4. Delay rentals paid on undeveloped leaseholds in a sum in excess of $488,000 (R., V. 6, 3106-3108).

The Commission, in refusing to recognize the actual cash consideration which Canadian paid for its leaseholds and in applying its "prudent investment" theory to a mining enterprise such as the acquisition of "wildcat" oil and gas leases in an area more than 200 miles from known oil or gas production, denied *in toto* the value created by the "wildcatter" or prospector as the result of his discovery. It eliminated many costs actually incurred, and which costs, such as delay rentals, must be recognized, in any event, if the "wildcatter" is to be reimbursed for his actual expenditures in cash. In this case the Commission adopts and applies a theory which, if followed consistently, would prevent the "wildcatter" not only from realizing any profit upon his extremely hazardous venture, but would actually deny him the right to recover his entire out-of-pocket expense.

In addition to the original purchase from Amarillo, Canadian from time to time made other smaller purchases of gas leaseholds, one of these being the purchase of the properties of Master Oil and Gas Company consisting of 5404.2 acres of leaseholds and two gas wells for the sum of $235,054.20 (R., V. 5, 2659-2661, 2815-2816). The Commission deducted from this purchase price the sum of $12 ,787 (R., V. 1, 150). This deduction was made on the ground that Prairie Oil and Gas Company owned 51% of the common stock of Master Oil and Gas Company and that N. K. Moody was a Director of both the purchaser and the seller (R., V. 5, 2659-2661). No contention was made that the price was excessive. The Record is clear that in determining the so-called provable original cost of Master that Luttring, Commission witness, only went back to June 1, 1926, although the leaseholds were first acquired prior to 1920 (R., V. 5, 2659-2823). Not a dime was allowed for the original acquisition cost of the leasehold. There is nothing in the Record that would indicate that this was anything other than an arm's length transaction. There is no showing that the indirect relationship between Prairie

and Canadian had anything whatsoever to do with the determination of the purchase price. Certainly, it cannot be said from the Record that Moody was in a position to dominate, in any sense, the action of the majority of the Board of Directors.

The Commission also deducted $244,853.26, being interest during construction on the alleged excess over provable costs paid by Canadian to Amarillo (R., V. 1, 149, Entry 249; V. 5, 2769). Obviously, if the entire $5,000,000 purchase price is allowed, the interest during construction actually paid upon this amount should also be allowed.

The Commission also deducted an additional sum of $128,000, being an alleged profit made by Mission Oil Company over and above actual provable costs (Mission is one of the predecessors in title of Amarillo) (R., V. 1, 150; V. 5, 3043-3051). Obviously, this deduction should not have been made if the full $5,000,000 purchase price is allowed.

The sum of the above deductions or eliminations by the Commission aggregates the sum of $3,615,670, which is approximately 36% of the entire investment of Canadian in all of its properties (R., V. 1, 149) and almost 40% of the rate base determined by the Commission for Canadian in this case (R. V. 1, 164).

4. *Allocation.*
(Question 8).

As indicated on the Flow Map, Appendix B, Canadian has two general types of sales and businesses, i. e., (a) intrastate sales and business wholly within the State of Texas over which the Commission has no jurisdiction, and (b) interstate sales and business over which the Commission has limited jurisdiction. Canadian's interstate sales, substantially all of which are to Colorado Interstate, are again divided into two types of sales and businesses, i. e., (a) gas sold to Colorado Interstate for resale directly to its own pipe line consumers, such as Colorado Fuel and Iron Corporation and Colorado Portland Cement Company, over which the Commission has no jurisdiction (hereinafter sometimes referred to as "direct sales" or "direct sale gas"), and

(b) gas sold to Colorado Interstate for resale to distributing companies and others, such as Public Service Company of Colorado and City of Colorado Springs, for ultimate public consumption, over which the Commission does have jurisdiction (hereinafter sometimes referred to as "resale gas").

In arriving at its ultimate rate reduction order in this case, the Commission admits that it made no separation of Canadian's properties as between those used for its intrastate business and sales and those used for its interstate business and sales; likewise, it made no separation of Canadian's properties as between those utilized for direct sale gas and those utilized for resale gas. In lieu of such separation of properties, the Commission arrived at its ultimate rate reduction order through the application of a so-called cost of service allocation or formula submitted at the hearing by Commission witness Lyon and subsequently adopted by the Commission (Ex. 226; R., V. 4, 2317-2337, 2381-2384; Com. Op., R., V. 1, 175).

Both Canadian in its case and Colorado Interstate in its case (No. 379) introduced evidence before the Commission segregating and showing the portion of their respective properties, revenues, expenses and earnings subject to the Commission's jurisdiction and the portion not subject to the Commission's jurisdiction (R., V. 4, 2264-2355; V. 8, 5039-5044), all of which was ignored by the Commission. It is Canadian's contention that such a separation of properties was indispensable for the purpose of keeping the Commission within its jurisdictional limitations in accordance with the mandates of this Court.

In the application of the cost of service formula, Lyon, as well as the Commission, treated the properties of Canadian and Colorado Interstate as a unit, combining all their investments, costs and operations into one composite system (R., V. 4, 2317-2363-2399). The Commission's rate reduction orders, however, were entered against the separate properties and businesses of Canadian and Colorado Interstate and not against the composite pipe line system (R., V. 1, 176, 185-188).

Again, in the application of the cost of service formula

Lyon, as well as the Commission, assumed jurisdiction in the Commission over Canadian's production and gathering properties, facilities and business, as well as its transmission properties, facilities and business.

Canadian contends that the Commission's so-called allocation of cost of service is not a valid substitute for a proper separation of properties, revenues and expenses as between regulable and non-regulable business. It further contends that even if such a cost of service formula should be held to be a valid substitute in principle for a proper separation of such properties, it is fallacious and invalid as applied in this case, as will be shown in the argument to follow on this question.

A portion of Canadian's intrastate sales consists of sales from its transmission line in Texas for distribution in the towns of Hartley, Dalhart and Texline, Texas. The cost of service for such sales, as determined by the application of Lyon's formula, completely ignored the fact that these towns were located in close proximity to the gas field and applied to them the same transmission cost factors as were applied for determining the cost of gas at Denver, Colorado. When effect is given to all adjustments made by the Commission, this resulted in a "cost" allocation for these Texas communities which was in excess of the amount actually received by Canadian for such gas (R., V. 4, 2317; V. 5, 2425).

In the application of their cost of service formula, both Lyon and the Commission have assumed that every foot of gas sold by Canadian is produced and gathered at precisely the same cost. In other words, they have given no consideration whatsoever to the load factors involved in serving direct sale customers or resale gas customers (R., V. 5, 2414-2415-2421).

All gas sold by Canadian to Colorado Interstate for the latter's direct sale customers is utilized for industrial fuel purposes, the demand for which is not greatly affected by weather or temperature conditions. Colorado Interstate's peak monthly demand at Clayton Junction for resale gas for ultimate public consumption during the winter of 1939-1940 was approximately 50% greater in volume than direct sale

gas (R., V. 8, 5045). Since the peak monthly demand for resale gas was approximately 50% greater in volume than direct sale gas, it follows, obviously, that the utilization of producing and gathering facilities by resale gas was likewise approximately 50% greater than by direct sale gas.

Canadian's total sales to Colorado Interstate at Clayton Junction during the year 1939 are divided as follows: Resale gas 10,974,156 Mcf (14.65-pound pressure base); direct sale gas and gas used by Colorado Interstate in its own operations 10,458,353 Mcf (14.65-pound pressure base). Canadian's sales to Colorado Interstate at Gray, Oklahoma, during the same period were 20,783,301 Mcf (R., V. 4, 2319). Gas sold by Canadian to Colorado Interstate at Gray, Oklahoma, was resold by the latter to Natural Gas Pipeline Company of America and the Record does not indicate what amount of such sales represents direct sale gas to pipe line consumers. It is clear, however, that approximately one-fourth of Canadian's total sales to Colorado Interstate are sold by the latter directly to its own pipe line consumers. Notwithstanding the fact that the Commission has no jurisdiction over such sales made by Colorado Interstate, the Commission's rate reduction order, nevertheless, purports to reduce the price of *all* gas sold by Canadian to Colorado Interstate, including direct sale gas.

As above stated, Lyon in his Exhibit 226, which was adopted and applied by the Commission, combined all properties of Colorado Interstate and Canadian and treated them as one composite system. This being true, in the consolidation, Lyon eliminated Colorado Interstate as a purchaser from Canadian and Canadian as a seller to Colorado Interstate. His exhibit contained no basis within itself for the determination of the cost of service of Canadian with respect to the gas sold by it to Colorado Interstate. The Commission, nevertheless, ordered a total over-all reduction with respect to all gas sold by Canadian to Colorado Interstate in the amount of $551,000 annually (R., V. 1, 176). It is the contention of Canadian that, in any event, there is no support in the Record for the Commission's action in this respect.

Reference is here made to the Statement of the Case in

the Brief of Colorado-Interstate (No. 379) which Statement explains in detail the method followed by Lyon and the Commission in allocating "cost of service".

SPECIFICATION OF ERRORS.

1. The Commission erred in assuming and exercising rate regulatory jurisdiction in this case over Canadian's production and gathering properties, facilities and business, and the Circuit Court, after correctly ruling that the Commission did not have such jurisdiction, erred in concluding and ruling that the Commission in this case did not exercise prohibited rate regulatory jurisdiction over Canadian's production and gathering properties, facilities and business.

2. The Circuit Court erred in approving the action of the Commission in ignoring the market value of Canadian's natural gas as a commodity at the wellhead in the field and at the end of its gathering system, which is the beginning of the interstate transportation of said gas, and is not holding that the Commission should use such commodity value of said gas at the end of the gathering system as the Commission's jurisdictional starting point for rate regulatory purposes in this case.

3. Even assuming, *arguendo*, that the Commission does have rate regulatory jurisdiction over Canadian's production and gathering properties, facilities and business, the inclusion in the rate base of Canadian's natural gas leaseholds on the Commission's original cost or prudent investment theory or formula, to the exclusion of all evidence of value, market or otherwise, was improper, illegal, and in violation of the Natural Gas Act, and deprived Canadian of its property without due process of law, in violation of the Fifth Amendment to the Constitution of the United States.

4. Assuming, *arguendo*, that the Commission has rate regulatory jurisdiction over Canadian's production and gathering properties, facilities and business, and further assuming, *arguendo*, that it is proper in this case to include Canadian's leaseholds and wells in the rate base on the basis of original cost or prudent investment, the Commission and the Circuit Court nevertheless erred, contrary to the Fifth Amendment

to the Constitution of the United States and to the Natural Gas Act, in not finding that the full $5,000,000 paid in cash by Canadian to Amarillo for Amarillo's gas leaseholds, wells and rights constituted a prudent investment and part of Canadian's original cost.

5. Assuming, *arguendo,* that the Commission has rate regulatory jurisdiction over Canadian's production and gathering properties, facilities and business, and further assuming, *arguendo,* that it is proper in this case to include Canadian's leaseholds and wells in the rate base on the basis of original cost or prudent investment, the Commission and the Circuit Court nevertheless erred in disallowing and eliminating from the rate base $3,615,670.26, or any part thereof, of Canadian's actual original cost and prudent investment, contrary to the Fifth Amendment to the Constitution of the United States and the Natural Gas Act.

6. The Commission, in purporting to fix reasonable rates for gas sold by Canadian for resale in interstate commerce, and now subject to regulation by the Commission, violated the requirements of the Fifth Amendment to the Constitution of the United States and the Natural Gas Act when it treated Canadian's property and that of Colorado Interstate as a unit, and failed to make any separation of the property and expenses as between that applicable to interstate commerce and that applicable to the intrastate sale in Texas, or between that applicable to the sales for resale and that incident to the direct sales to Colorado Interstate's industrial customers over which the Commission has no jurisdiction; and the Circuit Court of Appeals erred in affirming the Order.

7. The Commission's "allocation of cost of service" is not a valid substitute for the required separation of property and expenses, in that it results in burdening non-regulable gas with costs actually incurred in the sale of the regulable gas, and in the regulation of business over which the Commission has no jurisdiction, contrary to the limitations of the Fifth Amendment and of the Natural Gas Act; and the Circuit Court of Appeals erred in affirming the Order.

8. The Commission erred in ordering a blanket reduction

in the rates of Canadian applicable to gas sold for resale in interstate commerce, as well as to gas sold in interstate commerce for direct sale in so far as the sales to Colorado Interstate are concerned, notwithstanding the fact that the Commission under the Natural Gas Act has no rate regulatory jurisdiction over gas sold in interstate commerce for direct sale to the ultimate consumer, and the Circuit Court of Appeals erred in affirming the Commission's Order.

9. For each and all of the reasons set forth in the foregoing specification the Circuit Court erred in affirming the Commission's Rate Reduction Order, and in not reversing, vacating, setting aside and holding said Order for naught.

ARGUMENT.

We shall present our argument in the numerical order of the "Questions Presented."

Question 1.

Exercise of Prohibited Rate Regulatory Jurisdiction Over Canadian's Production and Gathering.

It is submitted that all of the facts set forth in the Statement and its several subheadings are pertinent to this question.

We state here at the very beginning that we are not here questioning the inquisitorial powers granted to the Commission under Sections 5(b), 9(a), 10(a), 11(a), and 14(b) of the Act. It is, however, Canadian's contention that, notwithstanding the Circuit Court's ruling to the contrary, the Commission has exercised prohibited rate regulation over Canadian's production and gathering properties, facilities and business. In support of this contention the following is submitted:

(a) Section 1(a) of the Natural Gas Act declares the Congressional intent and sets forth the purposes of the Act "that the business of *transporting and selling* natural gas for ultimate distribution to the public is affected with a public interest, and that Federal *regulation* in matters relating to the *transportation* of natural gas and the *sale* thereof in interstate and foreign commerce is necessary in

the public interest." (Appendix A, infra, p. 89.) (Italics supplied.)

(b) Not only does the Act by Section 1(a) limit its scope and coverage to interstate transportation and sale of natural gas, but to foreclose all possibility of misconstruction or an unwarranted assumption of non-granted jurisdiction, Section 1(b) of the Act expressly provides that it "shall not apply to * * * the production or gathering of natural gas." (Appendix A, infra, p. 89.) Clearly the English language contains no words which could more positively express the Congressional intent than are found in these two subdivisions of the very first section of the Act.

(c) If aid to interpretation of the clear, positive and unambiguous language contained in Sections 1(a) and 1(b) of the Act is for any reason thought necessary or desired, it can be abundantly found in the legislative history of the Act where its sponsors, including the representatives of the Federal Power Commission, stated time and time again that the Act was not designed to and did not cover production and gathering. See statements of Mr. Dozier A. DeVane and Mr. Thomas J. Tingley, Solicitor and Assistant Solicitor, respectively, of the Federal Power Commission contained in the official report of "Hearing Before a Sub-Committee of the Committee on Interstate and Foreign Commerce, House of Representatives" in connection with the original H. R. 11662, pages 17, 28, 34, 35, 42, 43; statements of Chairman Lea, Congressional Record, Volume 81, Part 6, page 6721; and Senator Wheeler Congressional Record, Volume 81, No. 162, page 11981.

(d) This Court, in the Natural Gas Pipeline Company and Hope Cases, has approved actions of the Commission only because the Commission was found to have acted within the "ambit of its authority," and in the Hope Case (p. 287, Vol. 88 L. Ed., Advance Opinions) this Court stated:

"* * * And the Federal Power Commission was given no authority over the 'production or gathering of natural gas.'"

Again, on page 289:

"As we have said, the Act does not intrude on the

domain traditionally reserved for control by state commissions; and the Federal Power Commission was given no authority over 'the production or gathering of natural gas.'"

(e) The Circuit Court in its Opinion in this case (142 Fed. (2d), p. 952; R., V. 8, 5074, 5075), following the mandate of the Act and the ruling of this Court, correctly stated that "under Section 1(b) the Commission does not have express or implied rate regulatory jurisdiction of the production and gathering of gas," and that under Section 1 of the Act the production and gathering properties and facilities of petitioner, while part of its integrated operations, "lie beyond the range of the rate-regulatory jurisdiction of the Commission."

(f) We submit there is no room for interpretation contrary to the express language of the Act. Jurisdiction will not be implied. Before jurisdiction in any administrative commission is decreed, it must be clearly granted. If any conceivable ambiguity could be found in the Act, that ambiguity must be resolved against jurisdiction.

The above statements are so uniformly sustained by the authorities, both Court and Commission, that mere citation of a few of them should suffice without quotation.

Interstate Commerce Commission v. Cincinnati, N. O. & T. P. R. Co., 167 U. S. 479, 42 L. ed. 243;

Siler v. Louisville & N. R. Co., 213 U. S. 175, 53 L. ed. 753;

Interstate Commerce Commission v. Goodrich Transit Co., 224 U. S. 194, 56 L. ed. 729;

Backus-Brooks Co. v. Northern Pacific Ry. Co. (C. C. A. 8), 21 Fed. (2d) 4 (certiorari denied, 275 U. S. 562; 72 L. ed. 427);

Commercial Standard Ins. Co. v. Board of Ins. Comm'rs of Texas (Court of Civil Appeals of Texas), 34 S. W. (2d) 343;

Humble Oil & Refining Co. v. Railroad Commission of Texas, 128 S. W. (2d) 9;

51 Corpus Juris, page 36, Section 78;

Express Companies, 1 I. C. C. 349;
Nickel Plate Case, 79 I. C. C. 581;
~~*Acme Fast Freight, Inc.*, 2 M. C. C. 415.~~

(g) Inasmuch as the Circuit Court has definitely ruled, as a matter of law, that the Commission does not have express or implied rate regulatory jurisdiction of the production and gathering of natural gas, and the Respondents, or any of them, have not, by petition for writ of certiorari, attacked that ruling, such ruling is the law of this case, and we start with such adjudicated law that under the Act the Commission does not have rate regulatory jurisdiction over Canadian's production and gathering properties, facilities and business.

(h) In view of the express and positive provisions of the Act, the legislative history thereof, the ruling of this Court in the Hope Case quoted above, and the quoted language from the Circuit Court's Opinion, we are absolutely unable by recourse either to reasoning or imagination, to justify the lower court's ruling that what the Commission did in this case does not constitute a usurpation of rate regulatory jurisdiction over production and gathering so universally recognized as being expressly withheld from the Commission. The Commission itself makes no contention that it has not exercised rate regulatory jurisdiction over Canadian's production and gathering, but attempts to justify its action on the theory that an exercise of such jurisdiction is indispensable, although not granted by Congress, to a proper exercise of its delegated rate regulatory jurisdiction over interstate transportation and sale of natural gas. That this contention is without merit and that the Commission did in this case exercise prohibited rate regulatory jurisdiction over production and gathering are demonstrated by the following paragraphs:

(i) Mining operations, which include production of natural gas, have been uniformly held by this Court to be local in nature and not to constitute interstate commerce even though the product mined is destined to be shipped in interstate commerce.

Corporation Commission of Oklahoma v. Champlin Refining Co., 286 U. S. 210, 76 L. Ed. 1063;

Thompson v. Consolidated Gas Utilities Corp., 300 U. S. 55; 81 L. Ed. 510;

Heisler v. Thomas Colliery Co., 260 U. S. 245, 67 L. Ed. 237;

Oliver Iron Mining Co. v. Lord, 262 U. S. 172, 67 L. Ed. 929;

Carter v. Carter Coal Co., 298 U. S. 238, 80 L. Ed. 1160;

Hope Natural Gas Co. v. Hall, State Tax Commissioner of West Virginia, 274 U. S. 284, 71 L. Ed. 1049;

Jersey Central Power & L. Co. v. Federal Power Commission, 319 U. S. 61, 87 L. Ed. 1258.

(j) The fact that the production and gathering may affect interstate commerce does not vest rate regulatory jurisdiction in the Commission over production and gathering as the Natural Gas Act is different from other acts adopted in recent years which vested jurisdiction in commissions where the subject-matter of the act "affected" or "burdened" or "obstructed" interstate commerce.

National Labor Relations Board v. Jones & Laughlin Steel Corp., 301 U.S. 1, 81 L. Ed. 893. (National Labor Relations Act);

Sunshine Anthracite Coal Co. v. Adkins, 310 U.S. 381, 84 L. Ed. 1263. (Bituminous Coal Conservation Act);

United States v. F. W. Darby Lumber Co., 312 U.S. 100, 85 L. Ed. 609. (Fair Labor Standards Act.);

Federal Trade Commission v. Bunte Bros., Inc., 312 U.S. 349; 85 L. Ed. 881. (Federal Trade Commission Act);

California Rice Industry v. Federal Trade Commission, (C.C.A. 9, 102 Fed. (2d) 716). (Federal Trade Commission Act);

A. B. Kirschbaum v. Walling, 316 U.S. 517, 86 L. Ed. 1638, 1646. (Fair Labor Standard Act);

Walling v. Jacksonville Paper Co., 317 U.S. 564, 87 L. Ed. 460. (Fair Labor Standards Act);

Public Utilities Commission of Ohio v. United Fuel Gas Co., 317 U.S. 456, 87 L. Ed. 1162. (Federal Power Commission.)

While Congress may have the power to regulate matters *affecting interstate* commerce as well as matters *in interstate commerce*, all the above cases make it absolutely clear that Congress does not have to exercise its full power, and that where it only delegates jurisdiction over matters *in interstate commerce*, such jurisdiction cannot be extended so as to include matters which may be said to *affect interstate commerce*. It is for Congress, and not for the created commissions or the courts, to decide what jurisdiction should be delegated, and, as stated by the lower court in its Opinion in this very case, "the Commission does not have *express or implied* rate regulatory jurisdiction of the production and gathering of gas." (Italics supplied.)

In view of the exclusive language of the Act, it is clear that Congress did not leave, or intend to leave, any discretionary power with the Commission to determine in what cases it should or should not exercise rate regulatory jurisdiction over production and gathering. As we shall hereinafter point out, there is no merit from a factual standpoint in the Commission's contention that an exercise of rate regulatory jurisdiction over production and gathering is indispensable to an exercise of delegated rate regulatory jurisdiction over interstate transportation and sale. Furthermore, it is legally immaterial that the Commission thinks that rate regulatory jurisdiction over production and gathering is indispensable to an exercise of its delegated rate regulatory jurisdiction over interstate transportation and sales because Congress has decided that question by withholding such jurisdiction from the Commission, and it is not for the Commission to override the express Congressional declaration of intent. A similar contention that an exercise of an undelegated power was necesary in order successfully to carry out a delegated power was refuted in the following clear language by the Supreme Court of Texas in *Humble Oil & Refining Co., et al. v. Railroad Commission of Texas*, 133 Texas 354, 128 S.W. (2d) 9, 15:

"It seems to be argued that our gas utility statutes, by

necessary implication, confer the power on the Commission to fix the price of gas where it is sold by the producer on the premises of production to a public gas utility. We think that the power to fix prices and make rates by a board or commission is not to be taken as conferred by implication. Such power must be conferred under statutory or constitutional language that is free from doubt, and that admits of no other reasonable construction. Commercial Standard Ins. Co. v. Board of Ins. Com., Tex. Civ. App., 34 S. W. 2d 343, writ refused; Siler v. Louisville & N. R. Co., 213 U. S. 175, 193, 29 S. Ct. 451, 53 L. Ed. 753. These authorities could be multiplied many times; but they are sufficient. Certainly, it cannot be said that our gas utility statutes, in clear and unmistakable language, confer the power on the Commission to fix prices or rates which private gas producers shall charge public gas utilities.

"It is contended by counsel for the Commission that the power of the Commission to fix the price at which a mere producer of gas must sell his product to a public gas utility, even though such gas is sold at the point of origin, should be upheld because the Commission will be greatly hampered and circumscribed in regulating gas utility rates or prices if it cannot also fix the rates or prices that producers charge such utilities for the gas sold thereto. A full answer to this contention is to point to the fact that no statute has conferred such power on the Commission. Furthermore, the same argument could be used to sustain the power of the Commission to fix prices for all articles, things, and services sold to public gas utilities. Everything that the utility may lawfully purchase must be taken into consideration in fixing the ultimate gas utility rate. We grant that gas utility rates might more effectively be controlled if private gas producers could be compelled to sell gas to such concerns at prices determined and fixed by the Commission; but, as already indicated, that fact does not justify a court in upholding such a power in the absence of any sort of statutory authority. * * *"

(k) As stated at the very beginning of this argument, we are not questioning the inquisitorial powers granted by the Act to the Commission in the only sections of the Act in

which production or gathering are mentioned, which inquisitorial or investigation power, however, clearly has no connection with any rate regulatory power. Thus, Section 5(b) only empowers the Commission, either upon its own motion or upon the request of any state commission, to "investigate and determine the cost of production and transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or the sale of such natural gas." Section 9(a) relates to methods of keeping accounts, and particularly to depreciation and amortization accounts. Section 10(a) merely requires the filing of reports. Section 11(a) is in aid of legislation and state compacts. Section 14(b) gives the Commission power to investigate or determine the adequacy or inadequacy of gas reserves. This subsection is a part of the entire Section 14, headed, "Investigations by Commission; Attendance of Witnesses; Depositions," thus showing that the purpose of the section is to authorize investigations in order to aid the Commission in exercising its delegated powers. These sundry inquisitorial powers, as stated by the Circuit Court in its Opinion in this case, vest in the Commission no express or implied rate regulatory jurisdiction over production and gathering.

(1) As shown in the Statement and as found by the Commission, (R., V. 1, p. 143), as of December 31, 1939, Canadian held gas leaseholds on approximately 300,000 acres of land located in the Texas Panhandle Field in the State of Texas on which it had in operation a total of 94 gas wells. Its gathering system consisted of 144 miles of various size of pipe, all located in the State of Texas. The gathering system has two termini. One terminus is located at what is known as the Bivins Station in the State of Texas. At this point the gas there gathered is compressed and then transported by Canadian through its own transmission pipe line to Clayton Junction, near Clayton, New Mexico, at which point it sells the gas so transported to Colorado Interstate, and the latter company then transports such gas through its "Denver Line" and sells the same at various points in the State of Colorado. The other terminus of Canadian's gathering system is located at what is known as Fritch Station,

also in Texas. At this point the gas there gathered is compressed and then transported by Canadian through facilities leased from Texoma Natural Gas Company to a point in Oklahoma known as Gray Junction where the gas so transported is ~~also~~ sold to Colorado Interstate. This general picture is disclosed on the Flow Map attached hereto as Appendix B.

As shown from the above and as stated by the Commission in its Opinion (R., V. 1, p. 143), it thus appears that Canadian is engaged in several different and distinct business operations or functions: (a) Production, (b) gathering, (c) transportation, and (d) sale of natural gas. In addition to the sale of natural gas to Colorado Interstate at Clayton Junction, New Mexico, and at Gray, Oklahoma, Canadian also sells natural gas to Amarillo Oil Company at the wells in the field for the City of Amarillo and the Town of Channing, Texas, and along its pipe line for the Dalhart, Hartley and Texline, Texas, markets. It also sells a small quantity of gas to Clayton Gas Company, with deliveries at the Clayton, New Mexico, town border. (R., V. 2, p. 708.)

The gas sales made by Canadian to Colorado Interstate are pursuant to a term contract between the two companies, dated January 3, 1928. (Ex. 16, R., V. 2, pp. 711-780.) It is the over-all compensation which Canadian is entitled to receive under this contract, including, among other things, the cost of current deliveries of gas as a commodity, which the Commission, by its rate reduction order, requires to be reduced in the amount of $551,000 annually. Among other things, this contract, known as the Cost Contract, for the compensation therein provided to be paid Canadian and which compensation has been reduced to the extent above stated by the Commission's order, requires Canadian to acquire, maintain and develop a substantial block of gas leaseholds, to drill and operate wells, to construct and operate gathering facilities, to pay off funded debt in fixed amounts at fixed times, and to sell gas to others only as permitted by Colorado Interstate.

(n9) An important fact in consideration of the question presented here is that there is a commodity market value for Canadian's natural gas in the field where produced and at

the end of the gathering system termini. The uncontradicted evidence in this case establishes the market value of Canadian's gas at the wellhead in the field at 4c per Mcf. (16.4-pound pressure base) and the fair market value of natural gas gathered and delivered at the Bivins Station (one terminus of the gathering system and the beginning of the transportation system) to be 7c per Mcf. (16.4-pound pressure base.)

We respectfully but earnestly submit that the Commission could keep within its delegated jurisdiction over interstate transportation and sale and not usurp an undelegated jurisdiction over production and gathering by using the commodity value of Canadian's natural gas at the end of the gathering system, which is the beginning of the interstate transportation system, as its jurisdictional starting point. The existence of a commodity value of the gas is in itself a complete answer to the Commission's contention that rate regulatory jurisdiction over the production and gathering properties, facilities and business, although withheld by Congress, is indispensable to an exercise of its delegated rate regulatory jurisdiction over interstate transportation and sale. So this case, or any similar case, need not be approached with the apprehension that if the Congressional mandate is followed and the Commission denied the right to exercise rate regulatory jurisdiction over production and gathering, the Commission will be unable properly to fulfill its delegated duties over interstate transportation and sale."

(n) As indicating the all-inclusive jurisdiction exercised by the Commission in this case over all of Canadian's properties, facilities and business, including not only its interstate transportation and sale but also its production and gathering, the following facts from the Record, summarized in the Statement, supra, are reiterated:

1. In arriving at its rate reduction order the Commission determined a rate base which includes not only Canadian's interstate transmission system but also its production and gathering properties. (R., V. 1, pp. 144-195; V. 5, pp. 2717-2721.)

2. In determining its rate base for Canadian's producing

and gathering properties the Commission applied its so-called original cost or prudent investment theories and in so doing totally ignored the true value of such properties as well as the actual cost thereof to Canadian.[5]

3. In its rate base for production and gathering properties the Commission determined and included an allowance for working capital which it deemed sufficient to enable Canadian to carry on its production and gathering operations, and likewise the Commission has purported to determine in its rate base for production and gathering properties what additional wells should be drilled and what additional gathering facilities should be installed in the future. (R., V. 5, pp. 2530-2556.)

4. After finding Canadian's total rate base to be $9,375,000 (R., V. 1, 187), of which approximately two-thirds represents production and gathering properties, (R., V. 5, 2717-2721), (even on the Commission's basis of determining a rate base), the Commission then found that Canadian was entitled to a return of 6½% per annum upon its total rate base (R., V. 1, 187), more than two-thirds of which, as above stated, is attributable to the hazardous business of discovering, exploring, developing and operating natural gas production properties.

5. The Commission has determined and made an allowance for Canadian's total annual operating expenses (including depreciation and depletion), the greater portion of which represents the cost of producing and gathering natural gas. (R., V. 1, 171; V. 4, 2341-2345.)

6. After determining the total annual income of Canadian from all sources, the greater portion of which represents the cost of producing and gathering natural gas under its Cost Contract with Colorado Interstate, the Commission has deducted its determined annual operating ex-

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[5] The Commission deducted $8,864,357 from Canadian's original costs, practically all of which is applicable to leaseholds. (R., V. 1, pp. 149-151) This is discussed under "Question 3" infra. The Commission included Canadian's bare leaseholds in its original cost rate base at a value of something less than $1,000,000, and in so doing totally ignored uncontradicted evidence of the present market value of such leaseholds in excess of $15,000,000. (See Statement, pages 19-21, supra. This is discussed under "Question 2" infra.)

penses (mostly production and gathering) from such total income, and then, after making a return allowance of 6½% upon its determined rate base (mostly production and gathering), it has found an alleged over-all excess income being received by Canadian, which forms the basis for its rate reduction order.

7. The Commission has applied its "allocation of cost of service" theory or formula to Canadian's production and gathering properties, facilities and business in the same manner as to its interstate transportation and sales and the properties, facilities and business connected therewith. This is discussed in detail under "Question 8," infra.

8. The Commission's Order changes and abrogates the amount of compensation which Canadian is entitled to receive from Colorado Interstate under its Cost Contract, which compensation represents cost reimbursement to Canadian not only for the cost of current deliveries of gas to Colorado Interstate, but also for the cost of performing various other services under the Cost Contract relating to Canadian's production and gathering properties and operations, such as the maintenance of leaseholds, the drilling of wells and the construction of gathering facilities as directed by Colorado Interstate.

(o) Notwithstanding all of the above and its own ruling that the Commission does not have either express or implied rate regulatory jurisdiction over production and gathering, the Circuit Court, in its Opinion, (142 Fed. (2d), p. 952-953; R., V. 8, 5074, 5075) sustained the Commission's rate reduction order upon a novel theory, therein attempted to be explained, that the action of the Commission does not constitute rate regulation of Canadian's production and gathering.

The Commission itself, either in its own Opinion or in its briefs filed in the Circuit Court or in this Court in connection with the petition for writ of certiorari, contends for no such theory, but admits that it did exercise rate regulatory jurisdiction over Canadian's production and gathering and claims to possess such jurisdiction.

We respectfully submit that while the Circuit Court in

one breath nominally purports to reject the Commission's jurisdictional contention, it does in its final and effective breath sustain the Commission's position notwithstanding the clear and positive provisions of the Act and the holding of this Court in the Hope Case. We submit it approaches absurdity to state that the Commission does not have rate regulatory jurisdiction over production and gathering and at the same time to rule that rate regulatory jurisdiction is not exercised where the Commission includes production and gathering properties in a rate base; where it applies its own formula of original cost or prudent investment to production and gathering properties; where it includes production and gathering expenses in its estimate of future expenses; where it allows working capital for the production and gathering business, and considers and determines what wells are to be drilled in the future; and finally, where, in determining an alleged excess revenue, it applies its allocation of cost of service formula or theory, including a 6½% rate of return, not only to the transmission system properties but also to the production and gathering properties which constitute approximately two-thirds of the total rate base as determined by the Commission. Obviously, the Commission has treated every element of Canadian's production and gathering properties, facilities and business in precisely the same manner as its interstate transmission properties, facilities and business, and has subjected every element of Canadian's production and gathering facilities to the same rate regulatory measures and procedures as Canadian's interstate transmission properties, facilities and business for the purpose of arriving at its ultimate conclusions with respect to rates and charges. If the Act had expressly delegated full and complete rate regulatory jurisdiction over Canadian's producing and gathering properties, facilities and business, the Commission could have done no more than it has done in this case. The Circuit Court Opinion is inconsistent and contradictory. Its effect, not only in the instant case but also in all other cases, if allowed to stand, is to vest complete rate regulatory jurisdiction over production and gathering and thus to assume and exercise a legislative veto power over an express and unambiguous Act of Congress.

We again emphasize that natural gas is a commodity; that the market value of that gas as a commodity at the wellhead and at the end of Canadian's gathering system, which is the beginning of its interstate transmission system, was established by uncontradicted evidence. The whole theory and purpose of the Act and the express Congressional intent set forth therein can be sustained, served and followed if this established commodity value of the natural gas be used as the starting point of the Commission's rate regulatory jurisdiction. In such event by using that commodity value as its jurisdictional starting point the Commission can properly proceed with an exercise of its delegated rate regulatory jurisdiction over the interstate transportation and sale of that gas.

In conclusion, we urge that the Commission's action in this case and the Circuit Court's affirmance thereof are in direct conflict wtih the Act and with the Opinion of this Court in the Hope Case, and that the Commission's unwarranted assumption of rate regulatory jurisdiction over Canadian's production and gathering should not be allowed to stand. If the Commission's action is permitted to stand, then the provision of Section 1(b) of the Act that the Act shall not apply to production or gathering has become merely surplusage and is a nullity.

Question 2.

Impropriety and Invalidity of Including Natural Gas Leaseholds in a Rate Base on an Original Cost Formula or Prudent Investment Theory.

While some of the specific facts in the Record pertinent to a consideration of Question 2 are summarized in the Statement under that separate subheading, all of the facts set forth in the entire Statement are more or less pertinent to a consideration of the question presented by Question 2: namely, the impropriety and invalidity of including natural gas leaseholds in a rate base (even assuming Commission rate regulatory jurisdiction over such leaseholds) on an original cost formula or prudent investment theory.

It is our definite position, raised in Question 1, that the Commission does not have rate regulatory jurisdiction over

the production and gathering of natural gas and that its delegated jurisdiction over interstate transportation and sale can be fully, adequately and properly exercised by determining the commodity value of the natural gas at the end of the gathering operation, which is the beginning of the interstate transportation. This clearly was the Congressional intent in expressly withholding rate regulatory jurisdiction over production and gathering from the Commission. Such a logical and practicable procedure would render it unnecessary to rely upon the inconsistent and contradictory subterfuge found in the Circuit Court's Opinion quoted above which denies jurisdiction and upholds Congress with one hand and at the same time legislates jurisdiction and thwarts Congress with the other hand.

Even, however, if it be assumed, *arguendo,* that by whatever name it may be called, rate regulatory jurisdiction is to be exercised over production and gathering, still we submit it is entirely improper, for various reasons hereinafter mentioned, to include natural gas leaseholds in a rate base at original cost and to allow only a return based upon such original cost.

We are not arguing here the question as to whether for the ordinary class of public utility property, original cost or something else should be the foundation of the rate base. Natural gas leaseholds constitute a class of property unique in itself and what may be a permissible or logical theory of a rate base for the ordinary utility property can have no proper application to gas leaseholds. Certainly there is nothing in the Act which requires the Commission to use original cost in including natural gas leaseholds in a rate base, even assuming that the Commission has rate regulatory jurisdiction over those leaseholds. Again, when this Court in the Natural Gas Pipeline and Hope cases stated that the Commission is not bound to any single formula or combination of formulas, it certainly did not intend to limit the Commission to an original cost formula in all cases. On the contrary, the "end result" and "rate impact" principles announced by this Court in these two cases would seem to make it absolutely clear that an original cost rate base as applied to natural gas leaseholds is

not only in conflict with the basic theory of the Natural Gas Pipeline and Hope cases but condemned by the "rate impact" and "end result" principles announced therein.

We submit that, except in an isolated instance as the result of accident, an original cost rate base as applied to natural gas leaseholds can never be fair to either the owner of the leaseholds or the public, and cannot, except accidentally, result in just and reasonable rates, as required by the Act. This can be demonstrated by a few general examples before coming to the particular situation which exists in the instant case.

A gas company, with $10,000,000 capital to spend in attempting to secure production, spends $9,000,000 of it around the country in geologizing, leasing, and drilling, without success. With its last million dollars it acquires some leaseholds which prove productive. Under the Commission's original cost theory the company would be limited to a 6½% return on this last million dollars. No consideration at all is given to the fact that it actually cost the company $10,000,000 to secure this one producing field. Such a theory must necessarily retard, if not eventually entirely terminate, attempts to locate and develop new fields, to the obvious prejudice of the general public.

Again, A acquires a section of purely "wildcat" land in unproven territory at a nominal cost of $1,000. He drills and secures gas production. This success immediately makes all surrounding land more valuable. B then acquires a gas lease on an adjoining section, but, because of the increased value resulting from A's discovery, B is required to pay $100,000 for his lease. B drills and is likewise successful. The gas produced from both leases as a commodity and on a competitive basis is of the same market value per Mcf. Under the Commission's original cost theory, A will be allowed a return of 6½% on only $1,000, while B will be allowed a return of 6½% on $100,000, and thus as far as the inclusion of the leaseholds in a rate base is concerned, the consuming public will be required to pay one hundred times as much for B's gas as for A's, even though they both have the same commodity value per Mcf.

This theoretical example just given is reflected by the actual facts appearing in the Record in this case. As shown from the Statement, ~~Canadian's leasehold acreage~~ was included by the Commission in its rate base on a "wildcat" original cost basis representing the nominal cost paid for the leaseholds, to a large extent before discovery of gas. In some instances what have turned out to be the most valuable leases were acquired in consideration of a drilling obligation only. The result is that all of Canadian's leaseholds, aggregating some 300,000 acres, have been included by the Commission in its rate base at an aggregate of less than $1,000,000 (exclusive of drilling cost). Five of its most important leaseholds, containing approximately 47,000 acres, have been included in the rate base by the Commission for only $4244.24, which is less than 10c per acre; and three of these leases are included at *zero valuation.* (R., V. 5, 2735, 2736, 3054.) The present fair value of these same five leaseholds (exclusive of wells, was $3,345,923. A similar situation exists in respect to the Commission treatment of the remainder of Canadian's leaseholds.

As against this practically nominal "original cost" of Canadian's leaseholds acquired on a "wildcat" basis, the Record shows that along about the year 1930 or 1931 Texoma Natural Gas Company[1] purchased a block of acreage approximating 300,000 acres in the Texas Panhandle Field at a total purchase price in excess of $15,000,000, the consideration paid running from $40 to $45 per acre. (R., V. 6, 3215, 3216.) Obviously the commodity value of the gas of the Texoma Natural Gas Company and the gas of Canadian is the same per Mcf., and yet the Commission's theory of including natural gas leaseholds in a rate base at original cost and allowing a return on such original cost would mean that ~~Texoma would receive~~ a return on from $40 to $45 per acre, and Canadian, a return on from zero value per acre to a maximum of $1 to $3 per acre. It would also mean that the rates to be charged the consuming public would be proportionately increased if the Texoma gas was purchased rather than Canadian's gas, notwithstanding

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[1] Texoma Natural Gas Company was a party to and its properties were involved in the Natural Gas Pipeline Company case.

that in the field and at the end of the gathering operations the commodity value of the gas of both companies is the same. The absurdity of this result is apparent.

A final example: A, mentioned above, with his $1,000 leasehold investment, develops a property containing a reserve of, say 50,000,000 Mcf. B, with his $100,000 investment, develops a reserve of 5,000,000 Mcf. Certainly, notwithstanding the difference in the leasehold investment or original cost, A's property is much the more valuable, and yet again, under the Commission's original cost theory, A will be limited to a 6½% return on his $1,000 as against one hundred times that much for B.

We submit that such a blind application of the Commission's original cost theory is unsound, impracticable, violative of the Fifth Amendment, must necessarily result in untold confusion, and cannot possibly result in just or reasonable rates either from the viewpoint of the owner of the leaseholds or the consuming public.

Of course, as we have urged above, this whole question can be avoided and order brought out of chaos if the Commission shall keep within its delegated jurisdiction and not attempt to include production and gathering properties in a rate base, but use the market value of the gas as a commodity as its jurisdictional starting point.

The impropriety, from legal, economic and practical standpoints, of applying ordinary public utility rate regulation principles and formulas to natural gas leaseholds and valuing such leaseholds for rate base purposes on an original cost basis, and the propriety of using the commodity market value of the gas as the jurisdictional starting point, are clearly and forcibly pointed out and emphasized in the opinion of Mr. Justice Jackson in the Hope Case.

In connection with our argument on "Question 3" infra we set forth the details of the actual original cost or prudent investment formula or theory promulgated and applied by the Commission in its valuation of Canadian's leaseholds for rate base purposes and the Commission's elimination of over $3,000,000 from Canadian's actual origi-

nal cost of those leaseholds. The argument there presented further demonstrates, we submit, the impropriety, from legal, economic and practical viewpoints, of ignoring, as a matter of law, all elements of value of natural gas leaseholds other than the original cost of those leaseholds incurred by predecessor companies on a "wildcat" acreage basis, and, in fact, emphasizes the impropriety, both from the viewpoint of the owners of the leaseholds and of the consuming public, of using original cost at all for natural gas leasehold rate base purposes.

The following additional facts summarized in the Statement, supra, further emphasize and clearly show the impropriety, if not the illegality and unconstitutionality, of including natural gas leaseholds in a rate base at original cost, even though that original cost be properly determined, which it was not in this case, as we show in our argument on "Question 3."

An analysis of the testimony of Commission witnesses, which the Commission adopted substantially (Ex. 146, Sheets 62-64; R., V. 5, 2717-2721), shows that the Commission used the sum of $1,604,020.61 as the starting point for its findings as to original cost of or investment in Canadian's leaseholds as of December 31, 1939. Then, as appears from Paragraph 8 of the Commission's formal findings (R., V. 1, 186), a deduction of $653,681 was made for depletion. This means that Canadian's bare leaseholds have been included in the Commission's original cost rate base at a value of something less than $1,000,000.

In adopting this valuation for rate base purposes, the Commission has wholly ignored substantial and uncontradicted evidence that "the present market value of Canadian's leaseholds" (excluding wells) is the sum of $15,646,787.64.

The Commission has found that Canadian's recoverable gas reserves are 2,800,000,000 Mcf. (R., V. 1, 159.) Reducing these figures so found by the Commission to its *value of the gas in place*, it appears that the Commission, in effect, has found the present value of the gas in place to be only 34/1000ths of one cent per Mcf. On a comparative basis,

and using the $15,646,787.64 valuation as applied to the Commission's finding of 2,800,000,000 Mcf. recoverable reserve, the value of the gas in place is approximately ½¢ per Mcf.

The Commission has wholly ignored all evidence of the market value of gas at the wellhead in the Texas Panhandle Field as a measure of the value of said leaseholds. The uncontradicted evidence, as shown in the Statement, established such a commodity market value of 4¢ per Mcf. on a 16.4-pound pressure base, or not less than 3.6¢ per Mcf. on a 14.65-pound pressure base. Likewise, the Commission totally ignored the uncontradicted evidence which established the market value of Canadian's gas as a commodity at the Bivins Station (end of the gathering lines and beginning of the interstate transmission line) to be 7¢ per Mcf. on a 16.4-pound pressure base, or approximately 6.3¢ per Mcf. on a 14.65-pound pressure base.

The Commission has found that Canadian's remaining recoverable reserves as of December 31, 1939, are not less than 2,800,000,000 Mcf. (14.65-pound pressure base); that Canadian's future rate of production will be approximately 55,000,000 Mcf. (14.65-pound pressure base) per year; (R., V. 1, 159); and that on that basis Canadian's recoverable reserves will last for 53 years. The gross value of the 55,000,000 Mcf. to be so produced annually at 3.6¢ per Mcf. is $1,980,000. The Commission has found (R., V. 1, 171) Canadian's total annual operating expenses to be $1,169,096, which includes gathering expense and transmission expenses, as well as producing expense. Even if all of this expense, however, be attributed to the production of gas at the well-head and be deducted from the gross annual value of $1,980,000, there remains a net income of $810,904 (based upon commodity value) for Canadian's gas production in one year, which is almost as much as the Commission has allowed in the rate base for the total of Canadian's leaseholds for all time.

It happens in this particular case that the application of the Commission's original cost theory to Canadian's gas leaseholds operates to the prejudice of Canadian. It might well be the other way in another case, in which event if

the Commission is consistent, the consuming public would be compelled to pay a higher rate because of a high original cost, notwithstanding the fact that the market value of the gas as a commodity would be the same, irrespective of the original cost of the leaseholds.

We submit that any theory which must end in such absurd results is inherently unsound, is not in the public interest, and is in conflict with the Fifth Amendment and violative of the principles announced by this Court in the Natural Gas, Pipeline and Hope cases. As the Commission's rate reduction order (even assuming, *arguendo*, rate regulatory jurisdiction in the Commission over production and gathering) is based upon such an unsound theory, it should not be permitted to stand.

Question 3.

Canadian's Actual Original Cost of Leasehold Properties.

The Commission did not question the fact that Canadian had actually invested in its gas properties the sum of \$14,648,821 in cash as of December 31, 1939. (R., V. 1, 149.) It deducted from such actual cash investment, for its rate base purposes, however, the sum of \$3,370,817 on the ground that such sum represented "affiliated company profits." (R., V. 1, 149.) It also deducted, in addition thereto, the sum of approximately \$245,000 representing interest during construction on such alleged profits.[7] (R., V. 1, 149-151.)

Virtually the full amount of such deduction arises out of the transaction heretofore related in which Canadian acquired from Amarillo all of the latter's gas leaseholds, rights and wells as of May 1, 1927, for the sum of \$5,000,000 for the purpose of inaugurating the Denver Project in 1928.[8]

[7] The Commission actually deducted \$366,507 for interest during construction. (R., V. 1, 149) Of this amount, however, only \$244,853.26 represented interest during construction on the alleged profit in the sale of leaseholds, rights and wells to Canadian. (Entry 249, R., V. 5, 2769) The remainder of the deduction for interest during construction as determined by the Commission resulted from a finding that the construction period terminated on July 1, 1928, rather than October 31, 1928, as contended by Canadian. (R., V. 1, 151)

[8] See Statement, pp. 10, 11, 21-26, supra.

The Circuit Court, in upholding the Commission in this deduction, stated that the purchase price paid constituted a "synthetic inflation." (R., V. 8, 5082.)

Having thus denied and deprived Canadian of its actual cash investment of $5,000,000 in gas leaseholds, rights and wells, the Commission then proceeded to limit Canadian for rate base purposes to its conception of the bare provable costs incurred by Amarillo and its predecessor in title for such properties. Following this practice, the Commission found that Amarillo, commencing with its "wildcat" discovery well in 1918, had invested in the properties sold to Canadian only the sum of $1,879,504 and that this sum should be further reduced by $128,534 by reason of an alleged profit of another predecessor company (Mission Oil Company) in a sale of property by it to Amarillo (R., V. 1, 150), all of which resulted in a so-called original cost to Amarillo of approximately $1,750,000, or approximately $3,250,000 less than the sum actually paid by Canadian in cash for such properties. In order to arrive at the true amount of the deduction, there should be added, of course, interest during construction on said sum for the construction period as determined by the Commission.

Based upon the facts heretofore and hereafter summarized, Canadian contends that the Record in this case establishes beyond question the following:

1. *The consideration paid by Canadian to Amarillo for such properties, and other terms and conditions of sale, as well as the agreement to buy and sell, were determined and agreed to by the three non-affiliated organizers of the Denver Project after prolonged arm's-length bargaining, long before formal consummation of the transaction and even prior to the incorporation of Canadian itself.*

Payne, who represented Standard in the negotiations which resulted in the acquisition of the gas leaseholds, rights and wells of Amarillo by Canadian, stated:

"The terms were agreed upon (contract of April 5, 1927, Exhibit 1) only after a series of conferences at which various plans were considered and the viewpoints of all the parties were put forward and thoroughly dis-

cussed. Since Standard Oil was assuming the responsibility of putting up the money for the project, we exercised the utmost care and our best judgment in all of the matters under consideration, and the willingness of the company (Standard) to proceed with this project depended entirely upon the basis agreed to by the parties.'" (R., V. 1, 493.)

Payne further stated that this led to prolonged negotiations and at times it seemed that an agreement would never be reached. (R., V. 1, 519-522.)

The first proposition advanced by Standard for the Denver Project included the purchase of the properties of some other subsidiaries of Southwestern in Texas. This proposition was rejected by Southwestern. (R., V. 1, 519.) Standard then proposed the purchase of the gas wells and leaseholds of Amarillo for the sum of $2,000,000, being $1,250,000 in cash and stock with a par value of $750,000. This was rejected by Southwestern. The various propositions advanced by Southwestern from time to time on behalf of Amarillo for its gas leaseholds, rights and wells were $15,000,000 in cash; then $10,000,000; and finally $7,500,000. (R., V. 1, 520.) The negotiations started in July of 1926 and continued into October of that year. Standard finally increased its proposal to $4,000,000 in cash with a fifty-fifty division of the common stock in the project. This was refused by Southwestern. (R., V. 1, 520.) Standard's last proposal was to pay $5,000,000 in bonds and $1,000,000 in cash. This was rejected by Southwestern.

In October, 1926, Southwestern made a counter-proposal involving a payment of $5,000,000 in cash to Amarillo for its gas leaseholds, rights and wells. This proposition was finally accepted in principle (R., V. 1, 520-521), and incorporated in the Memorandum of Stipulations executed by Southwestern, Standard and Cities Service as of April 5, 1927. (Ex. 1, R., V. 1, 381-401.)

The intensity of the bargaining by the parties over the price to be paid for Amarillo's gas leaseholds, rights and wells is further exemplified by the following testimony of Payne:

"Q. Were you in the position of making a trade with these people (Southwestern) as to the dollars that would be paid for these leases and wells which would go into the cost of the project?

"A. Certainly. My attitude * * * was that we wanted to make the pipe line project a financial success and an honorable credit. It was our effort, therefore, *to buy those leases at the lowest possible figure* that went into the project.

"On the other hand, Mr. Fitzpatrick and Mr. Moody (representing Amarillo), * * *, *were particularly and more vitally interested in getting as much cash as possible from the sale of those properties.*" (Italics supplied.). (R., V. 1, 524.)

Spencer, Vice President of Southwestern, testified as follows:

"Q. Mr. Spencer, a number of questions have been asked concerning a figure of five million dollars. Do you know if that figure was fixed, namely, the amount that the leases which went into this project from the Amarillo Oil Company was fixed in some document prior to the time when the Canadian River actually made the purchase?

"A. A consideration of five million dollars to be paid and paid by Canadian River to Amarillo Oil Company for its gas rights and properties was fixed in the pre-organization agreement dated April 5, 1927 between Southwestern, Standard and Cities Service."

Spencer then identified Exhibit 1, Memorandum of Stipulations of April 5, 1927, as the pre-organization agreement referred to.

"Q. Was Canadian River Gas Company a party to it?

"A. Canadian River Gas Company was not in existence at that time. The agreement provided for the subsequent organization by Southwestern."

"Q. When was Canadian River organized?

"A. February 1928."

(R., V. 1, 455.)

Spencer further stated that Canadian at the first meeting

of its Board of Directors held on March 27, 1928, adopted a resolution authorizing the purchase of Amarillo's gas leaseholds, rights and wells and that

"* * * The consideration to be paid by Canadian River to Amarillo Oil Company for such gas rights and properties had been previously negotiated and fixed by representatives of Southwestern, Standard and Cities Service in the Memorandum of Stipulations dated April 5, 1927. * * *" (R., V. 1, 405.)

He further testified as follows:

"Q. And at the time when the transaction that you referred to, namely the meeting of the Board of the Canadian River and the adoption of the resolution authorizing the payment of five million dollars for the acreage, when that took place were there any negotiations between Canadian River and the Amarillo Oil Company concerning that?

"A. None whatsoever. That was merely a part of the carrying out of the terms and conditions of the April 5, 1927 agreement."

(R., V. 1, 455-456.)

There was no affiliation of any character whatsoever between Standard, Cities Service and Southwestern at that time. Southwestern represented Amarillo in the negotiations by reason of the fact that it owned all of the common stock of Amarillo. In addition to Moody and Fitzpatrick, Southwestern was represented also by A. R. Jones, of Kansas City, who was President of Mission Oil Company, which owned approximately 49% of the common stock of Southwestern. Jones always appeared in the conferences when a proposition was being seriously considered. (R., V. 1, 519, 521.)

It is apparent from the above that in the negotiations referred to Standard for itself and Cities Service occupied the position of purchaser and Southwestern acting for Amarillo occupied the position of seller, and that the purchaser attempted to acquire the properties for the Project as cheaply as possible and the seller attempted to get as much as pos-

sible for them. It is evident, therefore, that every element of arm's length bargaining between non-affiliated parties was present and operating in the negotiations, as well as in the consummation of the transaction.

It is true that after the negotiations were finally terminated and the consideration and other terms agreed upon, the properties were actually transferred by Amarillo to Canadian. The Commission has seized upon this fact as the basis for its finding that the purchase and sale constituted a transaction between two wholly owned and affiliated subsidiaries of Southwestern. The Record clearly refutes this contention. The original negotiations and agreement could not possibly have been had between Amarillo and Canadian for the very simple reason that Canadian was not then in existence and was only created by Southwestern for the purpose of carrying out the terms and provisions of the Memorandum of Stipulations (Exhibit 1) dated April 5, 1927. Moreover, as hereinafter shown, Canadian is only a nominal subsidiary of Southwestern.

2. *The affiliation between Amarillo and Canadian is only nominal and does not exist in fact or in practice, and, in any event, did not arise until after the contract to buy and sell the properties in question was consummated and the entire consideration paid.*

The contract between the Project organizers for the purchase of the wells and leaseholds of Amarillo was executed on April 5, 1927. Canadian was not organized until February, 1928. (R., V. 1, 455.) Such contract provided that Southwestern should organize Canadian and maintain it *separate from its other companies and projects* for the purpose of acquiring, maintaining and operating such properties for the benefit of the Project. (R., V. 1, 381, 382, 518-521.) Canadian was subsequently organized by Southwestern pursuant to the contractual provisions above referred to. (R., V. 1, 405.) The contract of April 5, 1927, provided that Canadian would enter into, for the consideration therein expressed, a long term contract (known as the "Cost Contract") to sell gas to Colorado Interstate on a cost basis. (R., V. 1, 392.)[9]

[9]See Statement, pp. 11, to 13, supra, for a description of the Cost Contract.

Although the issued and outstanding capital stocks of both Amarillo and Canadian were eventually owned by the same company, i.e., Southwestern, the affiliation in the ordinary sense ended there. Through its Cost Contract with Colorado Interstate, which was provided for in the organization agreement of April 5, 1927, Canadian, its properties and its operations became so involved in contractual obligations to Colorado Interstate that during the term thereof it could not possibly function as a subsidiary of Southwestern in the ordinary or usual sense of the word. It could not declare and pay dividends to Southwestern because it could not have profits upon which to declare such dividends. It could not buy or sell property without the consent of Colorado Interstate. It could not borrow money or incur obligations without the consent of Colorado Interstate. It was for these reasons that the agreement of April 5, 1927, provided that Canadian should be organized and maintained by Southwestern separate and apart from its other subsidiaries. (R. V. 1, 361-382.) Southwestern does not, and could not realistically, include Canadian as a subsidiary in its consolidated financial statements.

As will be shown in the next subheading, the entire consideration of \$5,000,000 had been paid to and received by Amarillo prior to the incorporation of Canadian. (R., V. 1, 455.)

It is apparent from the above that any affiliation between Amarillo and Canadian is purely nominal and did not arise, in any event, until after Canadian was created in February of 1928, long after the organization agreement of April 5, 1927, had been made and the \$5,000,000 transaction had become fully effective, except for the formality of transfer.

The transaction in question was not a mere matter of inter-company book entries with no cash changing hands, as is ordinarily the case in a "write-up."

\$5,000,000 in cash was actually paid by Canadian for its properties, which sum represented outside funds advanced by outside non-affiliated interests (Standard) for that specific purpose. We quote from the testimony of Spencer with respect to the payment of \$5,000,000, as follows:

"Q. So that the cash started from Standard Oil Company then to the Colorado Interstate and then to Canadian River?

"A. That is right from a cash standpoint. * * *

"Q. So Southwestern Development Company was not taking five million dollars of its own funds and paying it to its own subsidiary?

"A. It got five million dollars of outside money."

(R., V. 1, 459.)

The Commission has found that Canadian actually paid Amarillo $5,000,000 in cash for the latter's gas leaseholds and wells in the Texas Panhandle Field. (R., V., 1, 150.)

Luttring, Commission witness, also testified that the payment of the $5,000,000 was contingent only upon two principal conditions, namely, the obtaining of a natural gas franchise in Denver and approval of the title to properties of Amarillo which it was intended would be conveyed, and that after those two conditions had been satisfied, the $5,000,000 would be paid. (R., V. 5, 2914-2915.) Luttring further testified:

"Q. * * *

"Ultimately the Amarillo Oil Company received by way of credits or otherwise the full amount of the purchase price of five million dollars?

"A. Yes."

(R., V. 5, 2938.)

It is perfectly apparent from the above that there was no element of a "write-up" in this transaction as suggested by the Commission. There could have been no "write-up" for the very simple reason that $5,000,000 was actually paid and the funds, for this purpose, were advanced for Canadian by Standard, which company had no interest whatsoever in Southwestern or any of its subsidiaries. Subsequently, Canadian repaid the advances out of its own funds. The money, therefore, came from sources entirely outside of the Southwestern holding company system.

The $5,000,000 was permanently and irretrievably paid to Amarillo as the purchase price for its gas leaseholds, rights and wells. There was no eventuality, inter-company or otherwise, which could have compelled Amarillo to return such purchase price, or any part thereof, to Canadian. Thus, we have here not only the form but the substance of a real transaction between two parties, and not merely the form which accompanies a write-up transaction.

In its answer brief to our original petition for certiorari, the Commission points out that the alleged profit made by Amarillo was carried on Canadian's books in a so-called "appreciation account" until 1939, and that no income taxes were paid on such profit by Amarillo. This has no significance whatsoever. At the time of this transaction, Southwestern had elected to file Federal income tax returns for itself and its subsidiaries on a consolidated basis. Once Southwestern had determined to file consolidated income tax returns for itself and its subsidiaries, it had no choice but to include Canadian in such consolidated income tax return after its incorporation. Consequently, any profit realized by Amarillo in the transaction was eliminated for income tax purposes in the consolidated return. (R., V. 5, 2638.) At the same time, however, it should be noted that such elimination of taxable profit resulted in a lower depreciation and depletion base for Canadian's and the consolidated group's future use for tax purposes which in the long run may well require the payment of more, rather than less, Federal income taxes. This is the whole story concerning this phase of the transaction.

Certainly, this method of handling the transaction in order to comply with income tax laws does not in any manner change the arm's length nature of the transaction as reflected by the uncontradicted evidence, or the fact that Canadian in good faith paid $5,000,000 in cash for the property and that the property was worth more than the price paid for it. As stated in the A. T. & T. and New York Telephone cases hereinafter referred to, these are the facts that really count.

Neither the transaction nor the so-called "appreciation account" resulted in any entry whatsoever in Canadian's

surplus account. (R., V. 5, 2637.) From an accounting standpoint there could have been no write-up unless it was reflected in Canadian's surplus account. Canadian had received no gifts and it was not resorting to inflation of its assets, synthetic or otherwise, because it had in fact paid \$5,000,000 in cash for these properties. Consequently, it had nothing to record in its surplus account. It is apparent that no matter how Canadian may have kept its books of account for tax or other purposes, and notwithstanding any evidence of the true arm's-length character of the transaction, and of the true value of the property, the position of the Commission and its staff would have remained the same, simply because it was a transaction, so they say, between affiliated companies.

4. The Record does not contain even an intimation that Canadian paid an excessive or imprudent price for its properties acquired from Amarillo. On the other hand, the Record amply demonstrates that the property acquired was and is worth substantially more than the amount paid.

Payne testified with respect to the reasonableness of the consideration paid as follows:

"Q. * * * Now, at the time you made this final agreement of \$5,000,000.00 * * *, was it your judgment then that that was a prudent business agreement to make on behalf of the business interests you represented (Standard)?

"A. I was satisfied it was a very good business deal * * *, yes.

"Q. And on the basis of the facts as they were then, is it still your judgment that that was a prudent business deal and that the leases and wells were worth what was paid for them?

* * * * * * *

"The Witness: That is still my judgment."
(R., V. 1, 525-526.)

Wallace testified that the leaseholds acquired, exclusive of all well costs, plus a small acreage of additional leaseholds, had a value at the time of the hearing of \$15,646,787.64. (R., V. 6, 3181-3254.)

5. *Prior to acquisition by Canadian, the properties in question had not been devoted, to a public use or to the transportation or sale of natural gas in interstate commerce.*

The Commission makes no contention or finding that Amarillo had ever devoted its properties to the public service prior to the acquisition thereof by Canadian. The Commission does intimate, however, that the properties acquired by Canadian from Master Oil and Gas Company and the properties acquired by Amarillo from Mission Oil Company had theretofore been devoted to the public service. (R., V. 1, 150.) This offhand statement, however, is not supported by the Record. Master Oil and Gas Company had never sold any gas for any purpose from its properties prior to the acquisition thereof by Canadian (R., V. 5, 2801, 2802) and the Record is entirely silent with respect to any sales by Mission Oil Company. Furthermore, the properties sold by Master Oil and Gas Company were in no sense involved in the purchase of Amarillo's gas leaseholds, rights and wells by Canadian.

The Record clearly shows that Amarillo had never devoted its properties to the public service. Its first sales of gas were made in October, 1920, to Panhandle Pipe Line Company, which was not then affiliated in any manner with Amarillo. (R., V. 5, 2861, 2927.) This gas was sold and delivered at the wellhead in the field, (R., V. 5, 2927-2928) and was ultimately consumed in Texas. It was produced from three wells, being Masterson Nos. 1, 2 and 4. (R., V. 5, 2862, 2866.) Obviously, these sales were not subject to regulation by the Commission for the very simple reason that (1) they were sales in intrastate commerce, (2) the Natural Gas Act authorizing regulation of the transportation and sale of gas in interstate commerce was not enacted until 1938 and (3) such sales, in any event, are not subject to regulation under the Act. Neither were such sales subject to regulation in the State of Texas. *Humble Oil & Refining Co. v. Railroad Commission of Texas*, 128 S.W. (2d) 9.

Commencing in 1923, Amarillo also sold gas to a zinc smelter located near the City of Amarillo, Texas. (R., V. 5, 2928.) This was an industrial sale and, therefore, no public interest or regulation attached. (R., V. 5, 2929.)

Amarillo acquired from Mountain States Gas Company in excess of 250,000 acres of leaseholds as of August 1, 1924. (R., V. 5, 3051, 3069.) There were no revenues from such properties by reason of gas sales or otherwise until after August 1, 1924. (R., V. 5, 3048.) Obviously, such properties could not have been devoted to a public service prior to August, 1924; nor thereafter, by virtue of the sales of gas by Amarillo at the wellhead produced from three wells *located on other property.* Finally, all of the leasehold properties and wells of Amarillo could not be said by any stretch of the imagination to have been devoted to a public service by virtue of local sales from three wells. Moreover, the properties involved in this case could not be said to have been devoted to a public service prior to 1938, in so far as the issues here involved are concerned, because Congress did not enact the Natural Gas Act until 1938. Prior to that date Congress had expressly excluded from regulation the transportation and sale of natural gas in interstate commerce. (34 Stat. 584; Title 49, U.S.C.A., Sec. 1 (1) (b).)

* * * * * *

There is absolutely no basis in the Record for the deduction of \$121,787 from Canadian's original cost on the theory that this sum represented a profit made by Master Oil and Gas Company in the sale of its properties to Canadian. As shown by the Statement, this transaction resulted from arm's length negotiations. No gas had ever been sold from the properties prior to the acquisition thereof by Canadian. (R., V. 5, 2801-2802.)

The Commission also erroneously deducted \$128,534 from Canadian's original cost, being the alleged profit made by Mission Oil Company in the sale of properties to Amarillo. The Record clearly demonstrates there was no basis for this action. Furthermore, this transaction involved production properties that were included in the sale by Amarillo to Canadian, and if the full \$5,000,000 purchase price is allowed for such properties, it necessarily follows that such deduction was erroneous.

It is, of course, perfectly obvious that the Commission was in error in deducting approximately \$245,000 for interest during construction on the alleged profit made by

Amarillo on the sale of its gas leaseholds, rights and wells to Canadian. This deduction was made on the theory (which is not supported by the Record) that such alleged profit was a write-up. (Com. Op., R., V. 1, 151.)

The refusal of the Commission to allow Canadian its actual cash investment in gas leaseholds, rights and wells for rate base purposes, and its application of original cost theories to production properties in this instance results in relegating Canadian to the provable cost of its predecessor companies and denies Canadian any return on $3,615,670.26 of its actual cash investment in such properties, including interest during construction, as well as the right to recover such sum through the sale of its gas.

We most earnestly contend that the undisputed facts in this case demonstrate clearly and conclusively that the Commission erred as a matter of law in holding that the transaction whereby Canadian acquired the gas leaseholds, rights and wells of Amarillo constituted a transaction between affiliated companies and that the alleged profits, therefore, constituted "affiliated company profits." The Circuit Court was also in error in holding that such alleged profits of Amarillo constituted a "synthetic inflation." The opinions of both the Commission and the Circuit Court clearly show that their conclusions were based upon the assumption that the transaction in question represented nothing more than an arrangement between two wholly owned subsidiaries of Southwestern. The Record clearly refutes this assumption and shows that the real transaction was between non-affiliated parties and that the purchase price was agreed upon only after prolonged arm's length bargaining between non-affiliated parties.

This Court has held on many occasions that a finding without evidence is beyond the power of a court or commission and likewise that a finding made upon evidence which clearly does not support it is an arbitrary act against which courts afford relief. We submit that under all of the circumstances the statement of the Commission with respect to "affiliated company profits" and the statement of the Circuit Court that such alleged profits constituted a "synthetic inflation" are arbitrary and being such cannot stand. This

principle was clearly stated by this Court in the case of *Northern Pacific Railway Co. v. Department of Public Works of Washington*, 268 U.S. 39, 44-45. Mr. Justice Brandeis, speaking for the Court, said:

> "* * * where rates found by a regulatory body to be compensatory are attacked as being confiscatory, courts may inquire into the method by which its conclusion was reached. An order based upon a finding made without evidence * * *, or upon *a finding made upon evidence which clearly does not support it* * * * is an arbitrary act against which courts afford relief. * * *." (Italics supplied.)

See also the following additional opinions by this Court:

> *Interstate Commerce Commission v. Union Pacific Railroad Co.*, 222 U.S. 541, 547;
> *United States v. Baltimore & Ohio, Southwestern Railroad Co.*, 226 U.S. 14, 20;
> *Interstate Commerce Commission v. Louisville & Nashville Railroad Co.*, 227 U.S. 88, 91;
> *Florida East Coast Railway Co. v. United States*, 234 U.S. 167, 185;
> *United States v. Abilene & Southern Railway Co.*, 265 U.S. 274, 288.

The Circuit Court, in characterizing the difference between the purchase price actually paid by Canadian and the alleged provable original cost of Amarillo and its predecessors in title as a "synthetic inflation," held in effect that the same was properly eliminated by virtue of *Pennsylvania Power & Light Co. v. Federal Power Commission*, 139 Fed. (2d) 445 (certiorari denied). This case has absolutely no relevancy to the facts in the case at bar. It involved merely the proper method of keeping accounts by licensees under the Federal Water Power Act, which Act prescribes the manner in which such accounts should be kept. There is no such provision in the Natural Gas Act. In addition to this, however, the Pennsylvania case involved a claim for construction profits by one company against another company, both of which were puppets of the same holding company system. In fact, both parties were merely departments of one common holding company system. This does not even remotely ap-

proach the situation with respect to Amarillo. Amarillo acquired and developed the properties in question almost ten years prior to the time they were sold to Canadian for the Denver Project and in the interim it had increased the value thereof very materially as the result of discovery and exploration.

The Pennsylvania case would be more nearly applicable to the facts here if Amarillo had been employed by Canadian to go out and assemble the leaseholds in question after the Denver Project had been inaugurated and then Canadian had paid Amarillo a profit for the work performed by it. It is too clear for argument that this is not the situation confronting this Court, yet that was the very situation involved in the Pennsylvania case. In this case Amarillo acquired the leaseholds before there was any affiliation whatsoever, nominal or otherwise, with Canadian and in some instances before there was any affiliation with Southwestern. Properties originally acquired by Amarillo in 1917 were located more than 200 miles from any known oil or gas deposits. The leaseholds at the time of acquisition had little or no value and, consequently, only a nominal sum was paid therefor. Amarillo held these leaseholds for a period of approximately ten years with a very meager return. In the meantime it had developed them into properties of great value as the result of extremely hazardous "wildcat" exploratory operations. The circumstances, therefore, do not even remotely approach a situation where one department of the same parent holding company performs construction work for another and claims a profit as a result thereof. The Pennsylvania case would not be applicable here, in any event, because of the arm's length negotiations. Likewise, the various other cases cited by the Commission on this point in its answer brief to our petition for certiorari involved, for the most part, questions of accounting by licensees under the Federal Water Power Act and profits for construction work performed in reality by one department of a holding company system for another. Obviously, such cases have absolutely no relevancy to the facts in the case now before this Court.

Even if the transaction whereby Canadian acquired gas leaseholds, rights and wells from Amarillo was solely one

between affiliated companies, and even if the properties acquired had been theretofore devoted to a public service, still the profit made by Amarillo could not be condemned and eliminated on such grounds alone. This very question has been recently decided by this Court in the case of *A. T. & T. Co., et al., v. United States, et al.*, 299 U.S. 232, 240, 81 L. Ed. 142. In that case Mr. Justice Cardozo speaking for a unanimous Court held definitely and positively that where properties were purchased from an affiliated company, or from a company that prior to the purchase had devoted such properties to a public use, any profit made by the selling company could not be written off or ignored if, as a matter of fact, "*the difference between original and present cost is a true increment of value.*" (Italics supplied.)

This principle has been reaffirmed in the recent case of *New York Telephone Co. v. United States, et al.*, decided August 24, 1944, by a three Judge court for the Southern District of New York, Advance Opinions, Federal Supplement, Volume 56, No. 7, Page 932. There was involved in that case the purchase of equipment by the New York Telephone Company from its parents, the A. T. & T. Company. The latter company owned all of the common stock of the former. The cost of such equipment on the books of the A. T. & T. Company, after depreciation, aggregated $8,468,169.81, whereas the purchase price paid by the New York Telephone Company was $12,634,680.38, or an excess over A. T. & T. Company's net book cost amounting to $4,166,510.57. The Federal Communications Commission ordered the New York Telephone Company to write down the actual cost of the property in question to the net book cost of the selling company. *The Court held that the purchasing company could not be required to write down the actual cost of the property if, as a matter of fact, it was worth the sum paid*, citing the A. T. & T. decision by this Court referred to above.

While these cases involved questions of accounting, the underlying principle is even more applicable here. It is important to a regulated company that its books of account reflect actual consideration paid for properties where the true value of such properties is in keeping with the consideration paid, but it is fatal to a regulated company if it is

unable to have actual consideration paid for properties reflected in its rate base where the true value of such properties is in keeping with the consideration paid.

Certainly, on the basis of the above principle, there is no ground for eliminating more than $3,000,000 from the purchase price paid by Canadian to Amarillo for gas leaseholds, rights and wells in 1928. As heretofore stated, the entire $5,000,000 was actually paid in cash and in good faith after prolonged negotiations between adverse parties. The Record reflects clearly that the property was worth even more than the amount actually paid by Canadian and, therefore, in the language of Mr. Justice Cardozo "the difference between original and present cost is a true increment of value."

Commission counsel also rely on the case of *Niagara Falls Power Co. v. Federal Power Commission*, 137 Fed. 787, 793-794 (certiorari denied). That case involved the determination of the value of properties conveyed by the owners thereof to a common company for which each of said owners accepted common stock in the same proportion that the value of the properties conveyed by each bore to the total value. In other words, this transaction constituted simply a pooling of assets into one common operating company. No money whatsoever passed from the purchaser to the seller. It was a merging or consolidation of assets and in the end each of the so-called sellers owned a portion of the combined assets. This was not true with respect to the sale by Amarillo to Canadian. This sale did not constitute in any sense a pooling of assets as suggested by Commission counsel. The sale by Amarillo and the purchase by Canadian was a condition precedent to the establishment of the Denver Project. *The money paid belonged to Amarillo definitely and exclusively and no contingency whatsoever could arise in the future which would affect its right to keep and retain the full purchase price paid.* The project might have failed completely, but even so, Amarillo would not have been affected, and neither would its parent, Southwestern, in so far as the $5,000,000 payment is concerned.

Any pooling in this case could not have occurred until after provision had been made for the acquisition of the gas leaseholds, rights and wells in question, including payment

to Amarillo of the full $5,000,000 purchase price in cash. This sum belonged absolutely to Amarillo without regard to the future operations or fortunes of the Denver Project. The Niagara Falls case, therefore, and the principle decided therein, can have no relevancy whatsoever to this case.

This Court has said in the Natural Gas Pipeline and Hope cases that the Commission is not restricted to any particular formula, or combination of formulas, in arriving at a rate base. Notwithstanding such latitude, however, these opinions clearly require that any formula, or combination of formulas, applied by the Commission shall bear some reasonable relationship to the admitted facts in any given case. This is clearly demonstrated in the concurring opinion by Justices Black, Murphy and Douglas in the Natural Gas Pipeline case wherein it is stated: "The Commission has a broad area of discretion for selection of an appropriate rate base. * * * Various routes to that end may be worked out by the expert administrators charged with the duty of regulation. * * * *The decision in each case must turn on considerations of justness and fairness which cannot be cast into a legalistic formula.*" (pp. 606-607) (Italics supplied.)

The formula, legalistic or otherwise, applied by the Commission in this case results in the inclusion of Canadian's leaseholds in its rate base at a zero valuation for some of Canadian's most valuable leaseholds and a value of only 10¢ per acre to a still greater block of important leaseholds, and a nominal value of not to exceed $1.00 per acre on the great majority of such leaseholds. The undisputed testimony proves that the leaseholds involved in this case were worth many millions of dollars, exclusive of the wells. Clearly, the formula applied by the Commission here does not meet any test of "justness and fairness."

The Commission in this case has restricted Canadian for rate base purposes to the provable costs of the owners of its leaseholds who first engaged in an extremely hazardous "wildcat" enterprise in search of oil and gas over 25 years ago. They naturally paid little for their "wildcat" acreage at the outset because such acreage had little or no value at the time of its original acquisition—in fact, it might have

been a liability because it had drilling obligations attached to it. The value was developed by exploratory operations and discovery, which preceded by almost ten years the purchase of such leaseholds by Canadian, and which preceded by twenty years the enactment of the Act, which for the first time subjected to regulation the transportation and sale of natural gas in interstate commerce for resale for public consumption. Certainly, the public interest does not require that the consumers of natural gas produced from such properties be given the entire economic benefit resulting from the extremely hazardous undertaking involved in the discovery and subsequent production of natural gas under such circumstances. Certainly, no one will engage in the business of drilling a "wildcat" well 200 miles from any known oil or gas production, as Amarillo did, if the return upon such undertaking is to be limited literally to 6½% on the cost of the hole in the ground. We submit that neither the public interest nor the Act requires and the Fifth Amendment prohibits a rate regulatory process based upon any such theory.

The Commission has applied its prudent investment theories blindly in this case. It has not taken into account the undisputed facts and the realities developed in the Record. It has not attempted to base its conclusions "*on considerations of justness and fairness*". Mr. Justice Brandeis in his celebrated opinions defined "original cost" or "prudent investment" as the amount actually paid to establish the utility. *State of Missouri ex Rel. Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U. S. 276. He developed there the theory that dollars were dedicated to the public service and not necessarily the property itself. This theory is based upon the assumption that the dollars actually invested at the time constitute the best evidence of value. This could not possibly be true in a mining operation such as this one where cost frequently has little relationship to value. The principle cannot apply also because the money invested by Amarillo and its predecessors in title in "wildcat" leaseholds was not invested in any sense of the word in a public service enterprise. The investment was made in a mining enterprise and at a time and under such circumstances that it could not be known whether the

property in question would ever produce natural gas. The great increase in value occurred by reason of the discovery of large deposits of natural gas. This necessarily preceded any sale of gas in interstate commerce or otherwise. Therefore, Amarillo and its predecessors in title did not in the first instance invest money in a public service enterprise of any character whatsoever. It is true that when Canadian acquired the properties from Amarillo that it did so for the purpose of producing natural gas, a portion of which would be ultimately transported and sold in interstate commerce. This was the first time, in any event, that any money was invested in or dedicated to a project that might be said to constitute a public service project. The money paid to Amarillo by Canadian, therefore, represents the very minimum prudent investment or original cost figure that can be applied in accordance with the principles announced by Justice Brandeis. In other words, the entire sum of $5,000,000 paid by Canadian to Amarillo for the latter's gas leaseholds, rights and wells must be recognized as a prudent investment if the undisputed facts in this Record are recognized. The Court will bear in mind that even when this investment was made the transportation and sale of gas in interstate commerce was not affected with a public interest and did not become so until the Act was passed in 1938.

We earnestly contend that the undisputed facts in this case demonstrate that the transaction whereby Canadian acquired the leaseholds, rights and wells of Amarillo was one between non-affiliated companies and that every safeguard necessary to insure a fair price and to render the transaction arm's length was present and operating here. There is nothing in the Record to indicate that the price paid was excessive or imprudent and, as a matter of fact, the uncontradicted evidence would justify a much higher consideration than that actually paid. There can be no question but that the properties were not devoted to the public service prior to the time that the sale was made. Amarillo's only sales prior thereto were at the wellhead and to an industrialist consumer, neither of which is affected with a public interest. Furthermore, the subsequent sales made by Canadian in interstate commerce for resale were not af-

fected with a public interest until the passage of the Act in 1938, almost twenty years after most of the property was acquired by Amarillo and its predecessors in title and more than ten years after the purchase of the same by Canadian. It is further contended that, in any event, the undisputed facts and circumstances in this case demonstrate clearly that the prudent investment theory as developed, construed and applied by the Commission in this case produces such absurd and unrealistic results that it cannot be applied here for the purpose of determining the rate base of Canadian with respect to the leaseholds as such. If such theory is to be applied at all, it cannot be applied to the "wildcat" cost of such leaseholds incurred by Amarillo and its predecessors in title. The very minimum prudent investment cost under any such theory must be the actual cash paid therefor by Canadian in 1928.

It is, therefore, clear that the Commission should have included in its rate base not only the full amount of the \$5,000,000 paid by Canadian to Amarillo for the latter's gas leaseholds, rights and wells, but also the full amount paid by Canadian to Master Oil and Gas Company for its properties and the full amount of interest paid by Canadian on the actual cash invested in properties prior to the termination of the construction period. If the full amount of Canadian's \$5,000,000 purchase price is allowed, it follows that any alleged profit made by Mission Oil Company in the sale of its properties to Amarillo becomes entirely moot and is eliminated as an issue in this case.

Question 8.

Allocation.

1. *Failure of the Commission to Make Any Property Separation.*

Where property is used in public service, it is universally acknowledged that the owner must be paid for that use. Where the owner uses such property only part time, or uses only a part of the whole property in such service, he is only entitled to be paid to the extent of that use. Where he devotes the same property during a part of the time or a part of the whole property to some purely private ven-

ture, he can demand for such use in such private venture simultaneously carried on whatever compensation may be agreed upon between him and the other parties in interest. This being the case, it would seem to follow from a simple application of common sense and without any elaborate argument and without any citation of authority that a separation of the property, based upon use, must be made in order to determine the payment that is due for such use in the public service. This proposition is so not only as a matter of plain common sense, but it exists in this case as a matter of law. It was incumbent upon the Commission as an administrative body in order not to transcend its jurisdiction to draw and observe two jurisdictional boundaries: First, the boundary line between interstate and intrastate commerce; and, second, the boundary line between sales for resale and direct sales not subject to regulation under the Act. The Commission is circumscribed by each of these boundaries.

The necessity of such a property separation is not only dictated by logical reasoning, but is required by the express mandate of this Court in its several previous decisions, including, among others, *Smith v. Illinois Bell Telephone Co.*, 282 U. S. 133, 146, 75 L. Ed. 255, 262, and the *Minnesota Rate Cases*, 230 U. S. 352, 435, 57 L. Ed. 1511, 1556.

This general proposition is presented at length in the Brief of Colorado Interstate in Case No. 379 and in order to avoid unnecessary duplication we shall not further elaborate herein our general argument on this point, but hereby adopt Colorado Interstate's Brief with respect thereto.

The Commission in this case has expressly ruled that a separation of property is not required. (R., V. I, 175.) In lieu of such separation, however, the Commission has invented and applied a substitute "allocation of cost of service" formula or theory, treating Canadian and Colorado Interstate as if they were one company instead of two separate companies, and treating their properties as a unit, notwithstanding the fact that the Commission has entered separate and individual rate reduction orders against each of said companies.

In the following subdivisions of the argument on this question we shall point out certain specific reasons why the Commission's allocation of cost of service theory is inherently fallacious and in any event, whether sound as an abstract theory, has been misapplied in this case to the grievous prejudice of Canadian. In connection with this subdivision, however, directed particularly to the necessity of a property segregation, we call attention to the following fallacies in the Commission's cost allocation theory which in themselves show the necessity of a property segregation in order for the Commission to keep within its jurisdictional limitations.

1. In the first place, as established by the uncontradicted evidence, there is a commodity market value for Canadian's gas at the wellhead and at the end of the gathering operations which has been entirely ignored by the Commission. Admittedly, only a part of Canadian's gas sales are subject to the Commission's jurisdiction. Certainly Canadian has the right to receive the fair market value of its gas as a commodity for that portion of its business which is not subject to the Commission's jurisdiction. When the Commission ignores the commodity value of all of Canadian's gas, both jurisdictional and non-jurisdictional, and makes its so-called allocation of costs directed to all the gas, it inevitably must follow that the Commission is exercising a rate regulatory jurisdiction over the non-regulable gas. This could all be avoided if a property separation had been made.

2. As we have pointed out under "Question 1", the Commission, notwithstanding the prohibitory and limiting provisions of the Act and the ruling of this Court, has, with the Circuit Court's sanction, exercised rate regulatory jurisdiction over Canadian's production and gathering properties, facilities and business. The Commission in exercising such jurisdiction has computed a rate base for Canadian's total properties. In that rate base it has included all of Canadian's production and gathering properties on its own theories of original cost and prudent investment, which are only a fraction of their proven fair market value and of Canadian's actual cost. Admittedly, only a

portion of these production and gathering properties is devoted to the production and gathering of gas which is sold and transported in interstate commerce for resale for ultimate public consumption subject to the Commission's jurisdiction. In arriving at its allocated costs and excess of revenue over costs, the Commission has applied a 6½% rate of return to the entire properties although those properties are only used in part for regulable gas. In determining excess revenue over costs it is clearly improper for the Commission to limit Canadian to a 6½% return on the value, however determined, of its non-regulable properties. This particular question is also presented at length in the Brief of Colorado Interstate, which argument is also hereby adopted.

3. As pointed out in the Statement of the Case, Canadian sells gas to Colorado Interstate under a Cost Contract dated January 3, 1928. (Exhibit 16, R., V. 2, 711-780.) Again in its application of its cost allocation formula, the Commission has made no segregation of the properties involved in this Cost Contract as between the regulable and non-regulable gas covered thereby, but has made a blanket reduction order of $551,000 annually in the aggregate amount of cost reimbursement which Canadian is entitled to receive under the Contract, notwithstanding the fact that a part of such compensation which Canadian is entitled to receive is for non-regulable gas and is for the performance of obligations over which the Commission has no rate regulatory jurisdiction whatsoever. In thus abrogating the compensation provisions of the Cost Contract as a whole the Commission has interfered not only with the price which Canadian is entitled to receive from Colorado Interstate for regulable gas, but also the price which it is entitled to receive for non-regulable gas over which the Commission has no jurisdiction. This again could all be avoided by a proper separation or segregation of properties, revenues and expenses as between those devoted to regulable gas business and those devoted to non-regulable gas business.

2. *The Fallacies of the Commission's So-Called "Allocation of Costs of Service" as a Substitute for a Proper Separation of the Property and Expenses.*

In view of the decisions of this Court holding that a separation of properties must be made for the purpose of properly determining costs applicable to regulated business as distinguished from unregulated business, it is our contention that the Commission's so-called "allocation of cost of service" cannot be accepted in principle or otherwise because, as the Commission has admitted, it made no such separation of properties. If we should assume, *arguendo*, however, that the Commission's substitute method, when properly applied, accomplishes the same thing (which it does not), it is our further contention that the application by the Commission of its method in this case is so completely at variance with the facts and realities that the results obtained can form no useful purpose whatsoever and must be completely rejected. Some of the errors in the Commission's method are easily demonstrated because they arise from a total disregard of material facts. Other errors are not so easily displayed for the reason that the Commission has failed to make appropriate findings to support its conclusions. As is pointed out in the Brief of Colorado Interstate in Case No, 379, which is hereby adopted on this point, this failure to make appropriate findings in itself constitutes reversible error. *U. S. v. Carolina Freight Carriers Corporation*, 315 U. S. 475, 488-489, 86 L. Ed. 971; *Interstate Commerce Commission, et al., v. Columbus and Greenville Railway Company*, 319 U. S. 551, 87 L. Ed. 1580.

The Commission found that $1,778,000 represented Canadian's total cost of service (including the Commission's uniform rate of return allowed on its total properties) and that $615,000 represented Canadian's total or over-all "Excess Revenue Over Costs". (R., V. 1, 176.) These *total* findings were based upon the Commission's consideration of Canadian's separate and individual properties, revenues and expenses. In breaking down and allocating this *total* cost of service and this total or over-all "Excess Revenue Over Costs" between regulable business and customers and non-regulable business and customers of Canadian, how-

ever, the Commission did not do so on the basis of Canadian's separate and individual properties, revenues, volume of sales and expenses, but combined all such sales with similar items of Colorado Interstate. The total "Excess Revenue Over Costs" represents, therefore, neither the costs of Canadian nor the costs of Colorado Interstate, but a conglomerate of the two. (R., V. 4, 2317, 2381.) The rate reduction order was then entered against Canadian separately and individually and not against the composite pipe line system. (R., V. 1, 176, 185-188.)

No attempt was made to allocate excess earnings, if any, between Canadian's regulable and non-regulable business based solely upon its own properties, revenues, volume of sales and expenses. This approach by the Commission resulted in saddling Canadian with expenses of Colorado Interstate which Canadian never incurred, and burdening Canadian's non-regulable business with costs and expenses which are not properly chargeable to such business, as will be more specifically hereinafter shown.

Wellhead Costs.

The Commission has approved and adopted the allocation method of the Commission staff (R., V. 1, 176), presented by Commission witness Lyon, which is demonstrated in his Exhibit 226. (R., V. 4, 2317-2337, 2381-2384.) In the determination of the cost of gas at the wellhead, Lyon, in his Exhibit 226, took into account many so-called elements of cost that were not incurred, and by the very nature of things could not have been incurred, by Canadian in the actual production of natural gas. It is apparent that he allocated or assigned to Canadian's cost of producing gas a substantial amount of the operating expenses of Colorado Interstate, which expenses could have absolutely no materiality in so far as the determination of Canadian's cost of production is concerned. One example should suffice to show the gravity of the errors committed in this respect. In allocating the combined Federal income taxes of both Canadian and Colorado Interstate, Lyon allocated $113,287.28 of such taxes to Canadian's cost of producing gas. (R., V. 4, 2327, Lines 13 to 17.)

In making a separate determination of allowable expenses

for Canadian, however, the Commission found that in the test year of 1939 Canadian paid only $66,403 for Federal income taxes on its entire operations. (R., V. 1, 167.) Obviously, the total amount of income taxes involved in the cost of producing gas would be less than the total amount paid, but, strange as it may seem, Lyon has allocated to Canadian's producing operations income taxes in excess of $113,000, almost $50,000 more than was actually paid by Canadian for its entire operations. Certainly, it takes no argument to demonstrate the error in this respect.

Canadian sells large volumes of gas at the wellhead to Amarillo Oil Company (R., V. 4, 2319, Lines 56 to 58), which gas is purchased and consumed wholly within the State of Texas (R., V. 2, 708; see, also, Appendix B) and is not subject to regulation by the Commission. Lyon's erroneous computation has the effect of saddling costs amounting to several thousands of dollars upon the production of this gas which obviously were never incurred by Canadian. This erroneous shifting of costs to Canadian's non-regulable gas sales decreases the actual costs attributable to regulable gas sold for resale in interstate commerce. It follows, therefore, that the intrastate gas sales have been unfairly and unjustly burdened with a cost never incurred and, as a consequence, the regulable sales have not been assigned a fair share of the cost. It also follows that the rate reduction order is excessive by the amount of the excessive costs placed upon non-regulable intrastate gas.

Aside from the errors resulting from the use of a "composite" cost of service as applied to Canadian's non-regulable business, the method of allocation developed by Lyon and adopted and applied by the Commission is also erroneous because it does not take into account load factors and peak demands with respect to production operations and requirements. (R., V. 5, 2414-2415; V. 4, 2397.) Lyon made no distinction whatsoever in the cost of producing industrial gas, largely direct sale, and domestic gas, largely resale. He considered that it cost just as much to produce gas for one type of market as another.

The peak monthly demand of Colorado Interstate at Clayton Junction during the winter of 1939-1940 for resale gas,

which is largely for domestic and commercial uses, was 1,-394,090 Mcf. (16.4-pressure base), while the demand for direct sale gas, which is for industrial uses, was 909,540 Mcf. (R., V. 8, 5045.) It follows, therefore, that the resale gas required a little over 50% more of the capacity of the wells during this peak month than did the direct sale industrial gas. The cost of providing the peak-month capacity for the resale gas, therefore, was 50% greater per Mcf. than for the direct sale gas. This being true, his failure to distinguish between the costs applicable to the two types of gas sales has the effect of burdening direct sale non-regulable gas with costs not incurred and to reduce by the same amount costs actually incurred in the production of gas sold for public consumption. Lyon recognized that the peak day demand increased the transmission cost for resale gas for public consumption. (R., V. 4, 2317, 2383.) This component of cost is just as applicable to gas wells as it is to transmission lines.

Gathering Costs.

Here again, many of the costs attributable only to the operations of Colorado Interstate were added to Canadian's gathering costs. For example, Federal income taxes in excess of $28,000 were included as a part of such costs. (R., V. 4, 2327.) This, added to the $113,000 included for Federal income taxes as a part of the cost of producing gas, aggregates in excess of $141,000 for income taxes alone, whereas $66,000 only were allowed by the Commission for all purposes. This erroneous inclusion of a cost which was never incurred by Canadian in the gathering of gas obviously placed an undue burden upon the intrastate sales of gas made from the pipe line in Texas to Amarillo for the Towns of Hartley, Dalhart and Texline.

As was true in the case of gas wells, no consideration was given to the peak demands made upon the gathering system. Lyon and the Commission merely *assumed* there was no difference in the cost of gathering direct sale gas and resale gas and as a result computed an *average* cost for gathering all gas (R., V. 4, 2329) although this factor was given some consideration with respect to transmission costs. (R., V. 4, 2317, 2383.)

The peak monthly demands made upon the gathering system are discussed in the preceding subdivision dealing with wellhead costs. It is apparent from the figures there quoted that if a proper division of costs had been made, it would have resulted in placing more costs upon the resale gas, which is subject to regulation, and, of course, lesser costs upon direct sale gas. The Commission's action in this respect unduly burdened direct sale gas with costs that were not incurred.

Transmission Costs.

In determining the cost of service of Canadian for the intrastate sales of gas to Amarillo Oil Company that are ultimately consumed in Dalhart, Hartley and Texline, Texas, the Commission took into account not only all of the properties and operating expenses of Canadian, but also all of the properties and operating expenses of Colorado Interstate, and applied its formula or method of allocation to the combined properties and operating expenses of both companies, thus treating both companies as one composite system. (R., V. 4, 2381, 2317-2363; V. 5, 2425; see, also, Brief of Colorado Interstate.) Dalhart, Texas, for example, is located approximately 45 miles from the Bivins Compressor Station (the beginning point of the Denver line) and approximately 30 miles from the limits of the Texas Panhandle Field. (See Commission staff—O'Connor's—Flow Map, Appendix B, attached hereto.) The greater portion of all the gas sold off of Canadian's pipe line within the State of Texas is sold at and consumed in Dalhart. The Commission's method of allocation of costs developed by Lyon results in Dalhart being assigned approximately the same cost per Mcf. that is assigned to the gas sold by Colorado Interstate to Public Service Company of Colorado at Denver, which point is almost 400 miles from the beginning point of the pipe line. Stated in another way, if the City of Dalhart were located at the northern terminus of Colorado Interstate's pipe line at Denver, the cost of service developed for delivering gas to Dalhart would be identical with the cost of service developed for delivering gas at its actual location, 30 miles from the gas field. This is true because the cost of this gas was computed on the

theory that the two companies constituted one composite system (R., V. 4, 2381) and no consideration has been given to the specific points of delivery from the pipe line. (R., V. 5, 2425.)

Certainly, there can be no justification on any theory for the Commission's action in this respect. The costs incurred by Colorado Interstate in transporting gas from Clayton Junction to Denver, a distance of approximately 300 miles, can have no possible bearing upon the costs incurred by Canadian in producing and gathering gas and transporting the same to Dalhart, Hartley and Texhoma in the State of Texas. *The value of Colorado Interstate's property for rate of return, depreciation or any other purposes and the amount of Colorado Interstate's operating expenses can have no possible relevancy to Canadian's operations wholly within the State of Texas with respect to gas which is not sold to Colorado Interstate and which is in no sense handled or controlled by Colorado Interstate. This overloading results in Canadian's intrastate customers being erroneously charged or allocated a part of Colorado Interstate's costs and so burdens the intrastate sales.*

Cost of Service to
Colorado Interstate

The Commission has ordered a reduction of rates with respect to gas sold by Canadian to Colorado Interstate in the sum of $551,000 annually. (R., V. 1, 176.) There is absolutely no evidentiary basis in the Record for any reduction whatsoever as to this particular sale, as will be developed hereinafter.

It is clear from the Commission's Opinion that it has adopted the allocation methods and principles of Commission witnesses and has purported to base its rate reduction order thereon. (R., V. 1, 176.) Such allocation methods and principles are embodied in the testimony of Commission witness Lyon and his Exhibit 226. It will be recalled that for the purposes of allocation, Lyon in his Exhibit 226 combined the properties and businesses of Canadian and Colorado Interstate and treated them as a composite system which resulted in an elimination or washout of all transactions between the two companies. (R., V. 4, 2377-238[illegible])

Table 1 of Exhibit 226 (R., V. 4, 2317) contains a complete summary of the allocated cost of service as determined by Lyon for each customer of Colorado Interstate and also for each customer of Canadian, *except Colorado Interstate*. There may be some basis in this Exhibit for determining cost of service to Amarillo and other customers of Canadian, but there is nothing whatsoever in this Exhibit or in the Record for the purpose of determining cost of service for gas sold by Canadian to Colorado Interstate.

The Commission has cast aside all of Canadian's testimony on the subject of allocation. (R., V. 1, 175, 176.) It follows, therefore, that the Commission has no basis whatsoever in this Record that will in any manner support its findings as to the cost of service of the gas sold by Canadian to Colorado Interstate or as to the excess revenue over cost, if any, resulting from such sales and, therefore, there is no basis in the Record for any rate reduction order with respect to such sales.

It appears from the Commission's Opinion (R., V. 1, 176) that the "allocated costs" of gas sold to Colorado Interstate aggregated \$1,575,000. It also appears from the Commission's Opinion in the paragraph just preceding the above finding that this "allocated costs" was based upon Lyon's Exhibit. This could not possibly be true for the very simple reason that neither Lyon nor any other Commission witness made any effort whatsoever to determine the "allocated costs" of the gas sold by Canadian to Colorado Interstate.

Since the \$1,575,000 alleged cost of service of gas to Colorado Interstate is not based upon any evidence in the Record, it is reasonable to speculate upon the origin of the figure. We believe its source is self-evident. The Commission has taken Lyon's *allocated costs* in Exhibit 226 for all of Canadian's customers, *except Colorado Interstate*, and has deducted this amount from Canadian's total *actual* costs to get a synthetic cost of service for Colorado Interstate. After allowing for Commission adjustments, the figures in Lyon's Exhibit 226 fully support this conclusion.

Now this happy method of supplying missing evidence might not be so objectionable if the cost of service to Ca-

nadian's other customers had been allocated on Canadian's *actual* costs, but this was not the case. It is clear from the Record, as demonstrated in the preceding subdivisions of this argument, that in determining the "allocated costs" of Canadian with respect to its intrastate sales, Lyon included many of the "costs" of Colorado Interstate and thus inflated the true costs to Canadian of such intrastate sales, both at the wellhead and for resale to Dalhart, Texline, and Hartley. As has been shown heretofore, the "actual costs" experienced by Canadian were substantially less than the "allocated costs." This computation, of course, could not give the true cost of service experienced by Canadian with respect to the sales made to Colorado Interstate.

We reiterate that there is no basis whatsoever in the Record that will enable the Commission to determine the cost of service for gas sold by Canadian to Colorado Interstate and, therefore, its rate reduction order with respect to such gas is purely arbitrary. If we assume on the other hand that the Commission may, nevertheless, sustain its rate reduction order on the basis of "actual costs," then we earnestly insist that such "actual costs" cannot be determined simply by subtracting "allocated costs" assigned to the non-regulable sales from the total over-all "actual costs" incurred by Canadian. This cannot be done because such procedure does not give the correct "actual costs" of such sales, and neither does it give the correct "allocated costs" in accordance with Lyon's formula. The Commission has utilized inflated and excessive "allocated costs" to determine the cost of service for non-regulable gas, while it has used only a *residue* of actual costs to determine the cost of service for regulable gas. Either horn of the dilemma results in assigning an insufficient cost of service to the sales to Colorado Interstate and thus results in a greater rate reduction order against Canadian than the Record justifies.

3. *The Commission Has No Jurisdiction Over Direct Gas Sales by Canadian to Colorado Interstate for the Latter's Industrial Customers.*

The Commission ordered a blanket reduction in the sales price of all types of gas sold by Canadian to Colorado Interstate (R., V. i, 177) and denominated such gas as resale gas.

The Commission wholly ignored the fact that approximately one-half of the gas sold by Canadian to Colorado Interstate at Clayton Junction was sold to the latter for resale to direct industrial consumers. (R., V. 4, 2319.) This gas was not subject to the rate regulatory jurisdiction of the Commission for two reasons: (1) The Commission considered the properties of Canadian and Colorado Interstate as constituting one composite system, and (2) the Commission has no rate regulatory jurisdiction over gas sold by Colorado Interstate to its direct industrial consumers and, therefore, there is no basis for regulating the price of such gas sold by Canadian to Colorado Interstate.

Lyon's Exhibit 226 shows that the total sales to Colorado Interstate at Clayton Junction for resale in 1939 was 10,974,156 Mcf. (14.65 pressure base) and that the direct sales and sales to Colorado Interstate for its own use, neither of which is subject to rate regulatory jurisdiction of the Commission, amounted to 10,158,353 Mcf., and that sales to Colorado Interstate at Gray, Oklahoma, which gas was sold by the latter to Natural Gas Pipeline Company of America, were 20,783,301 Mcf. (R., V. 4, 2319.) The Record does not show what proportion of the sales to Natural Gas Pipeline Company constituted direct sale or resale gas.

It is apparent from the above, however, that as a very minimum approximately one-fourth of the total sales by Canadian to Colorado Interstate was gas that was intended to be sold and was sold directly to pipe line industrial consumers. Since the Commission had no jurisdiction over this type of sale and since it treated both lines as a unit, it follows that the contract price for this gas could not legally be changed by the Commission. Since this constituted approximately one-fourth of the total sales, it is apparent, therefore, that the rate reduction order was excessive in any event, and from this viewpoint alone by approximately $135,000 annually. As a matter of fact, the rate reduction order is excessive by a still larger amount for the reason, as hereinabove pointed out, that the cost of delivering the direct sale gas was much less per Mcf. than the cost of delivering the resale or regulable gas.

Commission counsel have heretofore taken the position that, notwithstanding the fact that the Commission has no jurisdiction over direct sales of Colorado Interstate, it, nevertheless, does have jurisdiction over all sales by Canadian to Colorado Interstate. Such construction is directly contrary to the wording and spirit of the Act.

Section 1 (a) of the Act (15 U.S.C., 717) declares that

> "* * * the business of transporting and selling natural gas *for ultimate distribution to the public is affected with a public interest*, * * *." (Italics supplied.)

Certainly, the sale of gas which is not sold, or distributed, or intended to be sold or distributed, "for ultimate distribution to the public" could not under the express language of the Act be said to be affected with a public interest. If such sales are not affected with a public interest, then it certainly follows that they are not subject to the rate regulatory jurisdiction of the Commission.

Section 1 (b) of the Act provides that the terms and provisions of the Act shall apply

> "* * * to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, * * * but shall not apply to any other transportation or sale of natural gas * * *."

It is the provision just quoted that counsel for the Commission rely upon as the basis for their contention that all sales made by Canadian to Colorado Interstate are subject to the rate regulatory jurisdiction of the Commission. Counsel say that since such gas is resold by Colorado Interstate, the sales price may be regulated, even though much of such gas is sold directly to industrial consumers and is not sold for resale "for ultimate public consumption." This very narrow construction of the Act is in conflict with the clear provisions of Section 1 (a) and is not supported by Section 1 (b) of the Act even if such Section were considered separately and independently of Section 1 (a). It is clear, in any event, when the two are read together, that they express the clear

intent of Congress to regulate the sales price of gas transported and sold in interstate commerce only where such gas is later resold "for ultimate public consumption for domestic, commercial, industrial, or any other use, * * *." The phrase "for ultimate public consumption" modifies and restricts the subseq ent language of the clause quoted. Clearly, the gas sold by Colorado Interstate to Colorado Fuel and Iron Corporation, for example, for consumption by the purchaser was not sold "for ultiinate public consumption." On the other hand, gas sold by Colorado Interstate to the Public Service Company of Colorado, which latter company in turn resold the gas to the general public through its local distributing facilities in the City of Denver, was subject to the rate regulatory jurisdiction of the Commission, even though the distributing company sold a portion of such gas to industrial consumers. It is that latter type of sale that is obviously referred to in Section 1 (b) of the Act.

The contention of Commission counsel is fully answered by the provisions of Section 4 (e) of the Act which provide that when a natural gas company desires to increase its rates, the Commission may suspend such increases pending a hearing. It is then provided, however,

> "That the Commission shall not have authority to suspend the rate, charge, classification or service for the sale of natural gas *for resale for industrial use only:* * * *." (Italics supplied.)

It is apparent that Section 4 (e) provides, in effect, that if Canadian increased its rates to Colorado Interstate for that portion of the gas sold to the latter company for resale to direct industrial consumers, the Commission could not suspend such rate increase. This being true, it follows that such gas is in no sense subject to the rate regulatory jurisdiction of the Commission. Otherwise, Congress would certainly have empowered the Commission to suspend such rates pending a hearing when and if increases were made.

It is clear from the above that Congress never intended to empower the Commission, and as a matter of fact did not

empower it, to regulate the price for gas sold directly by the pipe line company to a direct industrial consumer. Such sales are not "for ultimate public consumption." On the other hand, a sale made to a customer for the purpose of resale through a local distributing agency for "domestic, commercial, industrial, or any other use" is obviously a sale "for ultimate public consumption" and, consequently, the sale to such a customer, even though at wholesale, is subject to the rate regulatory jurisdiction of the Commission.

Let us assume, for example, that Canadian sold no gas to Colorado Interstate at all, except gas that was resold by the latter to Colorado Fuel and Iron Corporation for use at its steel mills at Pueblo. The Commission has no right to regulate the rates charged by Colorado Interstate for the sale of such gas. This being true, by what authority could it be said that the Commission could, nevertheless, regulate the price paid by Colorado Interstate to Canadian for this gas. Certainly, to regulate such sales, in so far as Canadian is concerned, and not to regulate them, in so far as Colorado Interstate is concerned, would constitute a foolish and vain exercise of rate regulatory jurisdiction. Since the ultimate sale cannot be regulated, there can be no occasion for regulating the intermediate sale.

The Commission's rate reduction order against Canadian in this case is directed against *all* sales of gas by Canadian to Colorado Interstate, including gas which is resold by Colorado Interstate directly to its pipe line industrial consumers as well as gas resold for ultimate public consumption. As heretofore pointed out, the Commission's failure to make a proper and jurisdictional separation and allocation between these two types of sales has resulted in increasing the Commission's rate reduction order by a substantial amount and in penalizing Canadian accordingly.

CONCLUSION

For each and all of the reasons hereinabove set forth, the judgment of the Circuit Court of Appeals should be reversed

and the case remanded, with instructions to vacate, set aside and enjoin the Order of the Commission.

Respectfully submitted,

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APPENDIX "A"

The pertinent provisions of the Natural Gas Act of 1938 (52 Stat. 821, et seq.; Title 15, U.S.C.A., Sec. 717) are as follows:

Sec. 1(a) "As disclosed in reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.

Sec. 1(b) "The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas."

Sec. 4(a) "All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

Sec. 4(b) "No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges,

service, facilities, or in any other respect, either as between localities or as between classes of service."

Sec. 4(e) "Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, or State commission, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect: *Provided*, That the Commission shall not have authority to suspend the rate, charge, classification, or service for the sale of natural gas for resale for industrial use only; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to

be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible."

Sec. 5(a) "Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however*, That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates."

Sec. 5(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas."

Sec. 6(a) "The Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when

found necessary for rate-making purposes other facts which bear on the determination of such cost or depreciation and the fair value of such property."

Sec. 9(a) "The Commission may, after hearing, require natural-gas companies to carry proper and adequate depreciation and amortization accounts in accordance with such rules, regulations, and forms of account as the Commission may prescribe. The Commission may from time to time ascertain and determine, and by order fix, the proper and adequate rates of depreciation and amortization of the several classes of property of each natural-gas company used or useful in the production, transportation, or sale of natural gas. Each natural-gas company shall conform its depreciation and amortization accounts to the rates so ascertained, determined, and fixed. No natural-gas company subject to the jurisdiction of the Commission shall charge to operating expenses any depreciation or amortization charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation or amortization other than that prescribed therefor by the Commission. No such natural-gas company shall in any case include in any form under its operating or other expenses any depreciation, amortization, or other charge or expenditure included elsewhere as a depreciation or amortization charge or otherwise under its operating or other expenses. Nothing in this section shall limit the power of a State commission to determine in the exercise of its jurisdiction, with respect to any natural-gas company, the percentage rates of depreciation or amortization to be allowed, as to any class of property of such natural-gas company, or the composite depreciation or amortization rate, for the purpose of determining rates or charges."

Sec. 10(a) "Every natural-gas company shall file with the Commission such annual and other periodic or special reports as the Commission may by rules and regulations or order prescribe as necessary or appropriate to assist the Commission in the proper administration of this chapter. The Commission may prescribe the manner and form

in which such reports shall be made, and require from such natural-gas companies specific answers to all questions upon which the Commission may need information. The Commission may require that such reports shall include, among other things, full information as to assets and liabilities, capitalization, investment and reduction thereof, gross receipts, interest due and paid, depreciation, amortization, and other reserves, cost of facilities, cost of maintenance and operation of facilities for the production, transportation, or sale of natural gas, cost of renewal and replacement of such facilities, transportation, delivery, use, and sale of natural gas. The Commission may require any such natural-gas company to make adequate provision for currently determining such costs and other facts. Such reports shall be made under oath unless the Commission otherwise specifies."

Sec. 11(a) "In case two or more States propose to the Congress compacts dealing with the conservation, production, transportation, or distribution of natural gas it shall be the duty of the Commission to assemble pertinent information relative to the matters covered in any such proposed compact, to make public and to report to the Congress information so obtained, together with such recommendations for further legislation as may appear to be appropriate or necessary to carry out the purposes of such proposed compact and to aid in the conservation of natural-gas resources within the United States and in the orderly, equitable, and economic production, transportation, and distribution of natural gas."

Sec. 14(b) "The Commission may, after hearing, determine the adequacy or inadequacy of the gas reserves held or controlled by any natural-gas company, or by anyone on its behalf, including its owned or leased properties or royalty contracts; and may, also, after hearing, determine the propriety and reasonableness of the inclusion in operating expenses, capital, or surplus of all delay rentals or other forms of rental or compensation for unoperated lands and leases. For the purpose of such determinations, the Commission may require any natural-gas company to file with the Commission true copies of all its

lease and royalty agreements with respect to such gas reserves."

Sec. 19(b) "Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or set-

ting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 346 and 347 of Title 28, as amended."